

# **Partnerships for Sustainable Enterprise Growth**

**21<sup>st</sup> Century Vision for USAID and Its Partners in  
Eastern Europe and the New Independent States**

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# Executive Summary

## Introduction

This strategy for promoting private enterprise development has been prepared over a period of several months in consultation with USAID's implementing partners and host-country counterparts. It is being done at a time when USAID faces the critical challenges of 1) producing sustainable results in the face of a declining budget for the region, and 2) designing an effective plan for phasing out once the transition to a market based economy is sufficiently completed. The economies of some countries have progressed to the point where foreign assistance is no longer needed. Others are nearing this point. However, many have yet to implement the necessary reforms that will promote private investment and enterprise development.

Also at this juncture USAID and its partners have gathered nearly a decade's worth of experience in assisting private enterprises. This has taught us that completing the transition to a market based economy will be more difficult than first expected. We've also learned that there is no single approach that can be applied to all countries. Rather, the unique economic, political, cultural and social conditions of each country in transition demand that USAID's strategy provide meaningful guidance on designing programs so that they address local problems and leverage local opportunities to develop businesses.

Broadly speaking, USAID's programs have two objectives. One is to help businesses acquire the skills, tools and services necessary for them to improve operations. The second is to help governments to establish and maintain an open and competitive marketplace for businesses. USAID uses the term "graduation" to refer to the point at which its assistance is deemed no longer necessary. This strategy lays out the graduation criteria as it applies to private enterprises.

***The goal of USAID's enterprise development strategy in the ENI region is to accelerate the creation of well-functioning markets where the laws and regulations are conducive for the efficient functioning of micro, small and medium-sized, privately owned businesses.***

What's important to understand is that the strategy is not just about defining the best way to do enterprise development programs – whether it be technical assistance, finance, policy change, education or whatever. USAID has numerous partners that are skilled and experienced in managing such programs. Rather, the strategy is aimed at helping USAID staff and their partners understand the legal, institutional, and human resource barriers to creating both better businesses, and a better marketplace where businesses can compete. Armed with a better understanding about the range of factors that impact on enterprise growth – from the shop-floor to the highest levels of government – USAID and its partners will be able to better identify, design, implement and monitor their efforts. The strategy provides the conceptual framework, program descriptions, lessons learned and assessment tools that will be used for these purposes.

## Goal of USAID's Enterprise Development Strategy

The goal of USAID's enterprise development strategy in the ENI region is to accelerate the creation of well-functioning markets where the laws and regulations are conducive for the efficient functioning of micro, small and medium-sized, privately owned businesses. In addition to the implementation and enforcement of enabling legislation, the infrastructure and organizational support must be in place to serve the needs of growing enterprises.

Priority is given to micro, small and medium sized businesses because they provide the best solution for job-creation, income generation, and economic growth. This is evidenced by research done in the US and Western Europe that shows that businesses having fewer than twenty employees are the largest contributors to job growth within the economy.<sup>1</sup> USAID is also supporting the development of women-owned businesses. According to studies, these account for approximately 35 percent of enterprise growth in the region.

***Newly found political freedom can only be sustained as long as common citizens can be assured that they have viable opportunities for employment and investment, and the right to private ownership.***

These three classes of enterprises are also vital to sustainability of democratic reforms. USAID and many countries in the region still face the challenge of building an economic middle class that will, in turn, demand continuing openness in political processes. Newly found political freedom can only be sustained as long as common citizens can be assured that they have viable opportunities for employment and investment, and the right to private ownership.

## Stages of Enterprise Development in the Transition to a Market Economy

To help tailor enterprise programs to address conditions in each country where it operates, USAID will utilize a transition model that describes three stages of enterprise development. Each successive stage sees improvement in the quality of business, but more importantly in the legal framework that allows markets to function properly, the development of institutions that represent private sector interests, the quality of technical and managerial consulting services to support enterprises, the availability of financing, the skills and knowledge of entrepreneurs, and the government's commitment to completing privatization.

In stage one – Business Formation – private enterprises are working in an essentially chaotic regulatory environment with few services needed to expand their business. Their focus is on quick-turnaround of goods to maximize immediate profits.

At stage two – Market Emergence – some of the institutional and organizational structures are beginning to develop so that enterprises have a bit more certainty about their markets. At this stage they may be considering longer-term investments in manufacturing and other

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<sup>1</sup> When we use the term "enterprise" or "business" in this document, we are referring to these three sizes of enterprises, including agribusiness along with other industrial sectors. We will use specific language – large, state-owned, privatizing, etc. – when discussing other types of enterprises. The definition for size is based on the number of employees: micro having up to ten employees, small 50, and medium 250.

productive enterprises. Businesses also are starting to find ways of collective action to promote common interests. Formal financing is becoming more available. Government is debating enabling legislation. These developments in the institutions and organizations that serve business create an opportunity for USAID to work on the legal and marketplace factors that affect enterprise development, whereas in stage one the opportunity was limited primarily to working directly with enterprises and governments in the region.

Stage three – Formation of Functional Markets – is the point at which enterprises are able to compete in a transparent, well-regulated marketplace. There are a wide range of financial and technical services available for micro, small and medium sized enterprises. The government has a positive attitude towards business and takes the necessary steps to create a market economy. The public too understands the role of enterprises in creating jobs, income and economic wealth for the country. At this stage, USAID is focusing primarily on facilitating ongoing interaction among the stakeholders who impact on the competitiveness of markets, while also providing limited technical assistance and training to public and private sector institutions that shape the marketplace.

### Legacy Mechanisms for Sustainable Partnerships

USAID's role is finished once stage three has been completed. In place of the old style of socialist planning we envision there will be public and private sector institutions practicing new, more open ways of working together to promote continued growth of enterprise sector. These new styles of operating – based on the principles of market economics and terms “new partnerships for development.” And to help ensure that the economic and democratic reforms achieved will continue into the next millennium, USAID is putting in place several “legacy mechanisms.” These are organizations and programs that are being started with US government and US foundation funding to sustain partnerships primarily through private means well after USAID Missions close. Examples of such mechanisms are:

- Global Technology Network programs such as those in Romania, Bulgaria and Macedonia.
- Privatized Enterprise Funds such as those in Poland, Hungary and potentially Ukraine, Romania and Bulgaria.
- The Baltic American Partnership Foundation, endowed to provide training and grants to enhance the capabilities of Baltic NGOs.
- The proposed Polish American Freedom Foundation.

## Lessons Learned and the Selection of Strategic Program Areas or Priorities for Enterprise Development

As USAID looks ahead to its involvement in the ENI region at the turn of the century, several realities and lessons learned are shaping our thinking about what strategic program areas are needed for sustainable growth of enterprises:

1. The single biggest impediment to sustainable growth is the lack of progress in economic and commercial reforms that create a competitive marketplace for enterprises of all sizes. Many governments are stalled in passing new legislation, and even when passed they have limited capacity to implement and enforce a regulatory regime that allows markets to operate properly. *We must use USAID resources to facilitate frequent interaction among representatives from business and government that leads to the identification, implementation and enforcement of laws and regulations that foster open market competition.* Local expertise is available in most countries to address the analytical issues of economic reform. What is needed is greater political will and public pressure to promote reform, overcome corruption, and stop bureaucratic resistance to change. We must also be mindful of pursuing windows of opportunity to strengthen our interactions at the local government level about economic reforms and attracting business development in the community.
2. Enterprises need a stronger collective voice to promote legal and regulatory changes that help create a market economy. *USAID's best partners in this regard are local trade and professional associations. Other local non-profit organizations that seek to promote good governance and a civil society are also important partners because a well-governed, more democratic society helps create a better climate for investment. Also important are local policy analysts, think-tanks and researchers that can add better information and analysis to the debate about what direction the economic reforms should take.*
3. Enterprises will continue needing to learn and strengthen modern management techniques beyond USAID's presence. *Although direct technical and management assistance to firms provided by foreign experts can be valuable, it's important to foster the development of local services that will be available to enterprises after donor-funded assistance is withdrawn.*
4. The main impediment to enterprises having access to capital they need to grow their business is the lack of an investor friendly climate that could be gained by implementing economic reforms. *Although donor-supported financing schemes will*

*help some businesses, it's more important to push on the reform agenda to implement the laws and regulations that support a market economy in which a formal financial sector plays a role.*

5. In most ENI countries, society still has a significant degree of ambiguity about what is a market economy, what is the role of private enterprises, and why economic reforms are so important at this juncture. *Education and training for young entrepreneurs, and public education for consumers are important to ensuring that this and future generations can reap the benefits of a market based economy.*
6. Privatization has yielded positive results, but its full success depends upon: a) sufficient political will to complete privatization, b) a higher level of managerial accountability and better corporate governance, and c) the presence of a fair and competitive business environment. *Almost all countries in the region have completed small-scale and mass privatization and the focus should shift towards assuring managerial accountability to shareholders (corporate governance) and to establishing at least minimal conditions for fair competition.*

***Although direct technical and management assistance to firms provided by foreign experts can be valuable, it's important to foster the development of local services that will be available to enterprises after donor-funded assistance is withdrawn.***

Based on discussions with partners about the lessons learned, USAID has determined that its enterprise development activities should be designed along six strategic program areas. These are:

- legal and regulatory reform,
- association development,
- technical assistance and training for enterprises,
- financial services development,
- educating the next generation of entrepreneurs and managers, and
- promoting the political will to complete privatization.

The mix of specific activities will depend on the stages of enterprise development in a given country, as well as the efforts of other donor organizations and how they align with USAID's goals and objectives.



## Adapting the Strategic Program Areas to the Stages of Enterprise Development

As countries progress towards the formation of a functioning marketplace for enterprises, USAID's strategy will adapt to meet the changing needs of enterprises, the organizations serving them, and the institutions that affect competitiveness in the marketplace. Countries will not proceed at the same pace along all strategic program areas. In fact, there may be some forward movement in some areas, while there is stalling and sometimes deterioration in others.

Table 1, "Adapting Program Strategies to the Stages of Private Enterprise Development," provides a general overview of how the program strategies should be modified along the three stages of enterprise development. The table also includes a description of the final objectives for each area.

The trend in program evolution is one that moves away from using foreign experts to provide direct services or technical assistance towards building the human resource and organizational capacity locally to continue providing services or to continue promoting reforms necessary for a market economy. For example, at Stage One, Enterprise Formation, US experts are used as consultants for local businesses, whereas in Stage Two, Market Development, the role of US experts is to train local service providers in management consulting techniques. Even in Stage One, it is important to begin the training process for local experts in order to speed the transfer of skills and techniques.

***The trend in program evolution is one that moves away from using foreign experts to provide direct services or technical assistance towards building the human resource and organizational capacity locally to continue providing services or to continue promoting reforms necessary for a market economy.***

A similar approach applies to legal and regulatory reform. At Stage One, foreign experts may do policy analysis, and directly advise government officials about the need for, and benefits from, market reform. At Stage Two, more work is done to build the capacity of local organizations and the business community to advocate for reforms. This is essentially the "demand side" of reform. Local analytical expertise is also utilized at Stage Two, instead of foreign expertise, in order to build working relationships between local researchers or policy experts, the business community, and the public sector.

In some cases, limited USAID resources may make it difficult to work in all six areas. This is not an "all or nothing" approach, however. USAID and its partners need to scan the whole environment to determine where the bottlenecks exist, so that they can make informed decisions about where to focus. Because of the overarching constraint of a poor legal environment, we would expect to see the two areas of legal/regulatory reform and association development at minimum as part of a Mission's strategy. Work in other areas is important too, but it is better to make headway in a couple of key areas, rather than scatter resources among a number of programs to the point where each of them is under-funded and unable to make an impact.

## Using the Strategy for Designing Country Programs

The strategy is designed to be both a policy statement that articulates USAID's approach to enterprise development in the ENI region, as well as a planning tool that helps to inform decisions about programs and activities that should be implemented. The first step in this planning process is for USAID staff and their local partners to read through the document and discuss the concepts it contains about: the stages of development, the rationale for the strategic program areas, the transition assumptions that underlie USAID's approach to working in the region, and the criteria for determining when USAID assistance will no longer be needed. Adequate time and attention must be given to this step so that each member of USAID's local team has an opportunity to understand how/whether their specific activity is making a contribution to the enterprise development goals and objectives.

The second step is for USAID to complete a diagnostic that defines the stage for each of the six strategic program areas. This can be done through a combination of meetings with partners, review of local information sources, and a relatively minor level of original survey work depending on what is currently available. It is important, however, to use a combination of data sources to help cross-check and validate what the current situation is, and to capture the status and contributions of women entrepreneurs. A set of questions for each strategic program area is provided in Annex A.

Once the diagnostic is completed, USAID and its partners can review the results and discuss which current activities are appropriate, how they might be modified to meet changing conditions, and where new activities may be needed.

## Content and Structure of the Strategy Paper

This report contains five chapters. The first chapter discusses USAID's goal for enterprise development in the region, and why *partnerships* are important for the realization of that goal. Chapter 2 describes the transition model – Stages of Enterprise Development – that is the basis for adapting USAID's strategic programs so that they meet local conditions. Chapter 3 describes the six strategic program areas, and the lessons learned that come out of the last ten years of experience working with private enterprises in the region. The lessons learned section is a vital piece of the strategy because it draws on the findings and recommendations of USAID partners. Chapter 4 discusses how the strategic program areas adapt according to the stages of enterprise development. Chapter 5 provides some background information on the state of the enterprise sector in the region, and the new set of assumptions USAID is applying to the transition timeframe and the factors – economic, political and cultural – affecting it.

The annexes contain a set of diagnostic questions that can be used in identifying local conditions affecting enterprise development, information from the EBRD about transition indicators, a description of indicators to use in determining program strategies, and a bibliography of papers utilized in the strategic planning exercise.

**Table 1: Adapting Program Strategies to the Stages of Private Enterprise Development**

Program Strategy	Stages of Private Enterprise Development			Final Objective/Result
	Enterprise Formation	Market Development	Formation of Functional Markets	
Legal and Regulatory Reforms	<p>Educate public officials in the workings of an open market economy, changes needed in laws to achieve it, and the role of the government in private sector development.</p> <p>Inventory regulatory impediments to PE development.</p> <p>Survey firms.</p>	<p>Train associations and think tanks in policy analysis, strategic management tools.</p> <p>Facilitate stakeholder dialogue.</p> <p>Continued training for public officials.</p>	<p>Promote public-private partnerships for enterprise development.</p> <p>Promote public forums for debating issues, and regional networks to carry momentum for reform forward.</p>	<p>Laws and regulations that establish an open, competitive marketplace.</p> <p>Transparent legislative processes.</p> <p>Legal framework that promotes sound corporate governance practices.</p>
Trade and Professional Association Development	<p>Introduce entrepreneurs to the ideas of collective action to improve business opportunities.</p>	<p>Funding for association activities.</p> <p>Training in association management, advocacy, coalition building.</p>	<p>Support for regional networks of associations, coalitions.</p> <p>Partnerships with US counterpart associations.</p>	<p>Member-based associations of all types are serving the needs of the private enterprise sector.</p>
TA/Training for Enterprises	<p>Use foreign experts to provide direct firm-level TA.</p> <p>Identify and train local professionals in consulting and training techniques.</p>	<p>Reduce subsidies.</p> <p>Make greater use of local experts – continue training of local consultants and trainers.</p> <p>Focus foreign expert role on local services skill-building.</p>	<p>Service providers not reliant on USAID funding.</p> <p>Targeted funding to promote best practices (associations, information networks, etc.).</p> <p>Increase in regional trade.</p>	<p>Enterprises are buying services in the marketplace on a commercial basis.</p> <p>Local partnerships (public-private) help offset costs of services for small and micro sectors.</p>

**Table 1 (Con't): Adapting Program Strategies to the Stages of Private Enterprise Development**

Program Strategy	Stages of Private Enterprise Development			Final Objective/Result
	Enterprise Formation	Market Development	Formation of Functional Markets	
Financial Services	Do deals directly with businesses to demonstrate viable financing (credit for micro- and small-scale enterprises) to both borrowers and future lenders/investors.	Work with progressive banks with means to finance.  Introduce alternative approaches (equity financing, leasing, credit unions, etc.).  Continue with viable financing schemes (micro and other).	Some training in best practices.  Refinement of non-bank financing schemes.  Development of secondary capital markets.	Businesses of all sizes have access to a range of financial products that meet their capital needs to establish and expand their enterprise.
Educating the New Generation of Entrepreneurs and Managers	Training for educators in market economics.  Programs for youth.	Programs that provide youth and pre-entrepreneurs hands-on opportunities with local businesses.	Promote partnerships between business and education institutions for continuing education of managers, and for workplace training of young entrepreneurs.	A society that understands and values entrepreneurship and open market economic system.
Privatization	Small-scale and mass privatization is most easily accomplished.  Educate officials on the importance of privatization.  Establish processes for rapid, wholesale privatization.  Emphasize corporate governance.	Focus on tender privatization of medium and large companies.  Continue support for managerial accountability and corporate governance.  Focus on legal/regulatory reform and establishment of fair competition policy.	Focus primarily on establishing regulatory and competition policy.  Conclude privatization of "strategic" companies in case where limited resources can leverage significant results.	State owns a minor share of productive enterprises, and those that exist are not a drain on the state budget.  The majority of economic wealth is generated from the private sector.

# 1. Goal of USAID's Enterprise Development Strategy

## 1.1 The Important Role of Private – Mainly Micro, Small and Medium-Sized – Enterprise to Sustainable Economic Development

Privately owned enterprises are the most important foundation for economic growth in post-communist countries of Central/Eastern Europe and the New Independent States. In addition to their role in economic development, privately owned businesses – particularly micro- and small-scale enterprises – are vital to helping establish new democratic principals and institutions in the former communist world. Private enterprises can provide the jobs and income for an emerging middle class that will help to sustain reforms necessary to bring the former communist countries into the global marketplace of free nations. The entrepreneurs and managers that run businesses, too, are an important force within the society to counter government tradition of central command and control over economics and politics that dominated the region until the early 1990s. Women-owned businesses are also a major – though often unrecognized – component of this economic growth: current data from the region indicate that women-owned businesses account for approximately 35 percent of total enterprise growth.

Robust micro, small and medium sized businesses are essential to economic development in the ENI region, just as they are to any growing economy. The most important contribution they make is to create jobs. Research pioneered in the United States during the late 1970's and through the 1980's shows that the majority of jobs in the U.S. economy were produced by small businesses. More precisely, the smallest businesses, those with fewer than 20 employees, consistently produced the largest share of job growth within the economy.<sup>2</sup>

Studies coordinated by the OECD during the 1980's confirmed that these results held for all of the major developed economies. Similar studies show similar results for most Asian economies and for many less developed African economies. Job growth is the byproduct of dynamic change in the economy as small businesses test new products and services, and identify and test new market niches. Even though the

### ***A Vision for ENI Enterprises in the 21st Century***

- Profitable businesses, of all sizes.
- Competitive markets where micro, small and medium sized businesses can succeed.
- A rule of law that supports transparency and ease of entry into and exit from the marketplace
- Regional networks that promote information exchange, trade and investment.
- A culture that values entrepreneurship and innovation.
- Governments that enable market forces to lead economic growth.

<sup>2</sup> From 1976 through 1982, for example, businesses with fewer than 20 employees represented 20.5 percent of U. S. employment, but produced 38.5 percent of net job growth over the period. See The State of Small Business, May 1985, Chapter 1, Table 1.9, page 22, U. S. Government Printing Office.

death rate of smaller businesses is high, the birth rate is even higher in those economies that do not inhibit business startups with excessive licensing, taxation or other factors that have the effect of increasing transaction costs to business startup.

Job growth may be the major argument for a dynamic and growing small business sector, and may be critically important in the former Socialist countries that must generate larger numbers of private sector jobs as the government sheds employment in state-owned or formerly state-owned enterprises. There are other important social and economic benefits generated by the growth of smaller enterprises. These include increases in personal wealth and the expansion of a middle class, which can contribute to the growth of democratic institutions within a country. Smaller enterprises also account for a significant share of innovation in an economy, approximately 55 percent of new innovations in the United States, for example. The innovation occurs naturally as smaller businesses test new markets and more accurately identify consumer needs within an economy.

***Micro, small and medium-sized businesses create employment, income, and economic growth. They also are vital to creating a middle class of entrepreneurs, managers, and employees that will sustain democratic principles and institutions.***

***USAID's goal for enterprise development in the ENI region*** is to accelerate the creation of well-functioning markets where the laws and regulations are conducive for efficient functioning of micro, small and medium-sized, privately owned businesses. In addition to the implementation and enforcement of enabling legislation, the infrastructure and organizational support must be in place to serve the needs of growing enterprises.

Over the past decade USAID has funded programs to privatize state companies, to improve enterprise operations, to create a viable financial services sector, and to promote the macro and micro level policy reforms that will shape a competitive marketplace for businesses of all sizes. These efforts have met varying degrees of success depending on a number of factors unique to each country – historical, political, economic, and cultural.

There are important regional and global dimensions to the market economy of each country. USAID is starting to plan some regional initiatives that will promote cross-border linkages among businesses and institutions supporting economic reform.<sup>3</sup> In this way, USAID hopes to strengthen East-East relationships that will help to sustain gains made in promoting democracy and market economics, and to build a larger community of interested partners that relate to US enterprise development objectives in the region.

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<sup>3</sup> These include: Global Technology Network programs such as those in Romania, Bulgaria and Macedonia; Privatized Enterprise Funds such as those in Poland, Hungary and potentially Ukraine, Romania and Bulgaria; The Baltic American Partnership Foundation, endowed to provide training and grants to enhance the capabilities of Baltic NGOs; The proposed Polish American Freedom Foundation, and; The Trust for Civil Society in Central and Eastern Europe.

However, much still remains to be done in the communities and the states where the new class of entrepreneurs and their employees live and work. From the perspective of the enterprise – particularly micro and small businesses – opportunities are being shaped by local factors. As local conditions for business improve, so does the potential for enterprises to become better linked into commercial opportunities with their immediate neighbors, as well as countries beyond their national borders. Developing the marketplace at home is a necessary first step to strengthening markets in the region. For these reasons, USAID remains committed to working at the community and national level, but at the same time it must develop partnerships with groups that can cross national boundaries and help to leverage declining donor budgetary resources.

This strategy aims to build on the successes USAID and its partners have had to date in enterprise development, and also to re-orient our assistance programs where needed to gain maximum benefit in the region.<sup>4</sup> Because USAID will be phasing out of country programs over the next several years, there is yet greater urgency in ensuring that the resources we have are used for maximum impact and sustainability after the withdrawal of US foreign assistance.

## 1.2 New Partnerships and USAID's Legacy for Sustainable Enterprise Development

As an economy moves through the various stages of private enterprise development, USAID's programming decisions will adapt to a changing set of constraints and opportunities. As the title of this paper implies, the approach for USAID's assistance program is to develop and promote *partnerships* that help to sustain the transition to a market economy. Partnerships are not only important as an end-objective, but also as a means for strengthening businesses, and creating an enabling environment in which they can compete fairly. We need to develop a sense of trust, mutual obligations, and shared interests on which a modern economy and an open political system depend.

***We need to develop a sense of trust, mutual obligations, and shared interests on which a modern economy and an open political system depend.***

How do partnerships relate to the goals of USAID's strategy in the region? Creating a market-based economy governed by principles such as private ownership, competition, enforceable contracts, low transaction costs, and the like essentially requires that new institutions be established, or at a minimum redesigned from institutions that were part of the former economy. A more accurate way to describe what is needed might be "*new*" *partnerships for sustainable enterprise growth*.

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<sup>4</sup> The term "partners" is used here in reference to the broad array of organizations and individuals that interact with USAID funded activities. The term "implementing partners" is used to refer specifically to grantees and contractors that manage USAID funded activities. Partners include them as well as host country counterparts and in some cases other donor organizations.

The role of government must radically change under the new system. Governmental bodies should no longer control the means of production; now they must learn to regulate rules of the marketplace to promote efficiency and equal access to the marketplace. Under the old system the governing elite related little to the public; under the new economic order public-private dialogue is crucial to improving the business climate, particularly because policy makers are unfamiliar with the needs of business and the functions of a market economy. Partnerships at all levels of government will be important, but experience suggests that working at the local level may in fact yield better results. In any case, working at the local or “grass roots” levels is important for building credibility in the national discussion about enterprise development and the economy.

The private sector also needs to partner with new institutions that will represent its interests, and influence public bodies from imposing excessive barriers to entry into the marketplace, and excessive taxes on private goods and services. In addition, business can partner with the intellectual elite and encourage them to stimulate public debate about the new economic order, roles of government, and importance of business to economic growth, among other areas.

***The term partnership recognizes that the emerging market economies will be founded on new institutions – new key players – and a new set of positive relations among those institutions, public and private.***

Businesses also need to partner with other types of service institutions that have emerged because of the transition underway. These include commercial banking, capital markets, legal services, business advisory/consulting services, investor services, and foreign agents to mention a few. These services must of course be competitive to attract enterprise clients that are willing to pay. But, in the macro sense they are partners to the enterprises because they have a common commitment to the principals of a market economy that will strengthen a broad range of industries in the region.

One purpose of the term partnership, therefore, is to recognize that the emerging market economies will be founded on new institutions – new key players – and a new set of positive relations among those institutions, both public and private.

A second purpose is to emphasize partnership as an important principal for implementing USAID’s enterprise strategy. Over time, the skills and technologies used by foreign experts must be transferred to local professionals, and local organizations. USAID and its program implementers will include explicit human resource and institutional capacity building objectives in their activities that strengthen local initiatives for enterprise development and market reform. This will be done by identifying local partners in the private, public and non-governmental sectors and engaging them in all phases of program design, implementation, and assessment. Their perspective will be critical to gaining a fuller understanding, too, of the local and regional conditions affecting the stages of enterprise development.



To help sustain and further develop these partnerships over time, USAID is putting into place new initiatives that are being called “legacy mechanisms.” These legacy mechanisms are being started with a combination of US government and US foundation funding, but will be supported over time primarily through private means. Their role will be to support local and regional efforts that help to further consolidate the gains made in establishing market economies and democratic institutions in the region. Examples of these mechanisms include:

- Global Technology Network programs such as those in Romania, Bulgaria and Macedonia.
- Privatized Enterprise Funds such as those in Poland, Hungary and potentially Ukraine, Romania and Bulgaria.
- The Baltic American Partnership Foundation, endowed to provide training and grants to enhance the capabilities of Baltic NGOs.
- The proposed Polish American Freedom Foundation.

The legacy mechanisms will need to have strong local partners in order to make the most effective use of their resources. Many of the local partners that USAID supports are ideally suited to work with these legacy mechanisms in the region. It’s important to begin working now with the best local partners so that they understand the meaning of partnership, and the importance of thinking and operating regionally to sustain the changes taking place today in their individual countries.

## 2. Three Stages of Enterprise Development

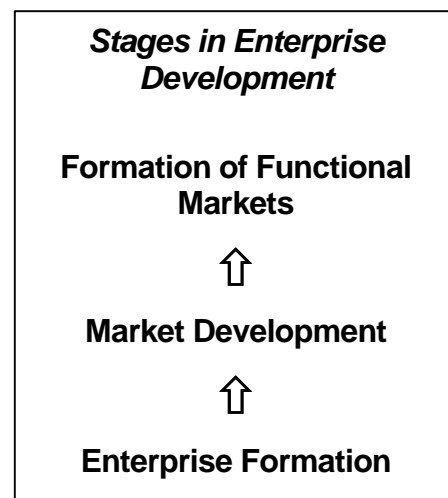
To facilitate the design and implementation of enterprise programs in the diverse countries of the ENI region, USAID has adopted a framework that describes three stages of enterprise development in transitioning economies. The stages begin with the formation of new businesses in a largely chaotic environment, and progress towards the establishment of a more regulated, open, and competitive marketplace. The stages focus on the strengths of businesses and the competitiveness of the marketplace because these are the critical elements for enterprise growth and (eventually) creation of a market-based economy.

The three stages are to be assessed in combination with six program strategies described in greater detail below. By ascertaining a country's stage of development in regard to business services, finance, associations, policy reform, training and education, privatization, USAID will be able to determine where best to focus its enterprise development resources and thus achieve maximum sustainable impact. To aid in this assessment, a set of questions is provided in this strategy document that will give country teams an accurate picture of what local conditions are, where problems lie, and where to find good local partners that share USAID's commitment to enterprise development and market economics.<sup>5</sup>

A questionnaire can be helpful in conducting a diagnostic, but the issue of where a country is with respect to a particular program remains partially subjective. Some judgment will have to be exercised in weighing complex factors, prioritizing and selecting programs within budget resources and timeframes. Many things are needed, and USAID clearly can't afford to do them all. But, using this framework will help establish sensible approaches based on local needs and opportunities.

It's also important to note that there are no firm breaks between stages, and the program strategies for each of them don't necessarily proceed at the same pace. Economies don't move through a set pattern of development for a common set of variables. Depending on local conditions, one program strategy may be at stage three whereas another may still be at stage two. The main point is to identify weaknesses in enterprises and institutions supporting them and to select program strategies accordingly.

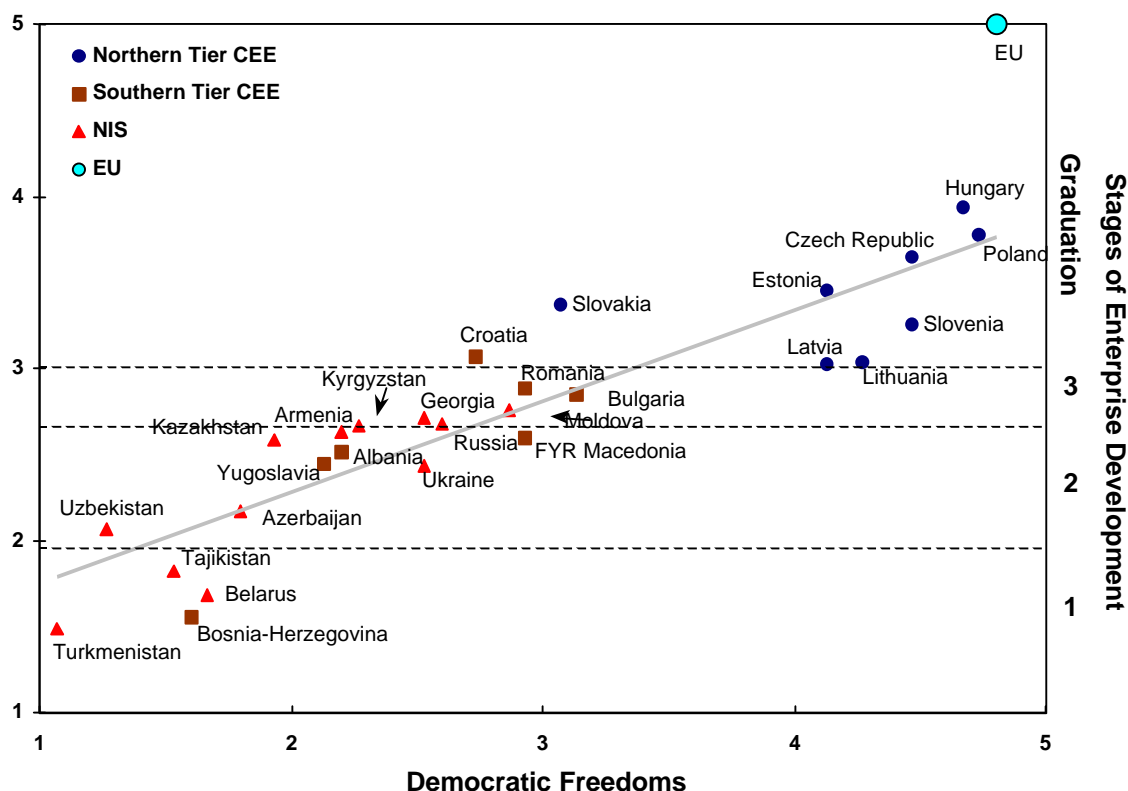
EBRD uses a similar approach in describing economic transition in the region. (See Section 5 and Annex B.) Whereas the EBRD model has a broader macro-economic focus, the USAID model tries to assess the local commercial conditions from the



<sup>5</sup> See Annex A: Stages of Enterprise Development – a Diagnostic Series of Questions. Also Annex C: Classification of Transition Indicators for USAID Program Strategies.

perspective of the enterprises – our ultimate clients. The three stages focus on the quality of enterprises and the role of institutional stakeholders in shaping the environment for business – both of which are key factors in the competitiveness of enterprises. The model can be used in designing intervention strategies and selecting local counterparts for collaboration.

Figure 1: Economic Policy Reforms, Democratic Freedoms and the Stages of Enterprise Development



Note: This chart is modified from the "USAID/ENI Stocktaking: Review of Program Assumptions." Ratings of Democratic Freedoms are from Freedom House, Nations in Transit October 1998, and assess reforms to April 1998. With one exception, economic policy reform ratings are from the EBRD Transition Report, November 1998, and cover events through early September 1998. Economic policy reform rating for Yugoslavia is from Freedom House (October 1998). Ratings are based on a 1 to 5 scale, 5 representing the most advanced. Stages of Enterprise Development scale is estimated.

Figure 1, which is modified from the USAID/ENI "Stocktaking Review of Program Assumptions," is an attempt to illustrate where each country is at along the transition towards economic reform, democratic freedoms, and enterprise development. In this document we are focusing mainly on developing the indicators for enterprises, but we are also mindful of other macro and political/institutional factors that affect the competitiveness of enterprises.

## 2.1 Stage One – Enterprise Formation

After the demise of communist central planning, and before the structures of an open market economy are being developed, let alone in effect, businesses must learn to survive in a chaotic environment with few established rules. At this stage governments are essentially hostile to private enterprise, and the image of crime related business that dominates people's thinking serves to undermine political will to reform. The looming prospect of post-privatization unemployment is also a disincentive.

The majority of businesses in this stage are new, undercapitalized, inexperienced and under-skilled in “best business” practices. To survive, they have to learn how to make profits quickly, since if they don't they will fail. In order to maximize the return on limited capital, many firms move into trade activities where they can turnover their capital very quickly. Businesses may be harassed by government officials and tax collectors that take advantage of the chaotic regulatory environment and by police officials who are underpaid and looking to augment their meager salaries. The businesses may also be harassed by organized crime. Extortion is a fact of life, and as a result, many firms chose to operate in the shadow economy.

***At Stage One, businesses must learn to survive in a chaotic environment with few established rules.***

The central government at this stage is unable to provide even the most rudimentary support services to smaller businesses. Most officials view their role as protecting consumers from predatory businesses, or they view businesses as a source of funds to supplement their government budgets and/or pay.

Banks are unwilling to lend to these small trading businesses, partly because they are transient (moving around to avoid harassment and taxation) and their owners are secretive and unwilling to share business information. The problem is compounded because banks have little capital and they are not accustomed to dealing with smaller commercial entities. Central bank funds are still being siphoned off among ailing state owned enterprises, making capital even more scarce. Bank supervision, banking law and other supporting legislation are absent or nascent. Businesses must tap informal financial resources when needed.

Success for most business owners is uncertain, but some are able – through luck, hard work, or previous training – to become more profitable. Other business owners may learn by watching these more successful entrepreneurs. Eventually, some enterprises accumulate enough capital (or import it from abroad) to move from distribution activities to production. This initial production often takes the shape of restaurants or bars, but other business owners move into food processing, other services, or small manufacturing activities. This stage is characterized by many marginal businesses, but there is some growth and development. The government for the most part remains an adversary to this business development. At this stage,

there is minimal product innovation, and the focus of entrepreneurs is on meeting immediate consumer demands, and achieving quick turnover of goods and services.

## 2.2 Stage Two – Market Development

Markets exist at all stages in the enterprise development model, but stages two and three are characterized by evolution in the marketplace that promotes competition, better business, more choices, and better goods and services for consumers.

As the name implies, markets become more developed at this stage, although a high degree of uncertainty still threatens the viability of individual enterprises. Survival is still uncertain for most micro businesses. Some smaller businesses, and some privatized state enterprises adapt to market conditions more rapidly, and expand their sales and profits. Government, for the most part is still an adversary, with high rates of taxation, large government deficits (which absorb private savings completely), some inflation, and a cumbersome business regulation and registration environment. Government attempts to control growth in many industries by creating complex registration and licensing activities. Legally registered businesses are taxed heavily because many state-owned enterprises are carrying heavy losses. Many businesses are operating in the shadow economy and are not taxed at all but end up paying protection, another cost of doing business. There is a strong incentive for businesses to deceive the government as the government tax collection process is perceived (often justifiably so) as inefficient, unfair, and corrupt.

***...stages two and three are characterized by evolution in the marketplace that promotes competition, better business, more choices, and better goods and services for consumers.***

Businesses are becoming more aware of the extent to which government is hindering business growth and development through taxes, registration and licensing, regulations and regulatory inspections and fines. There is a growing attempt on the part of business people to find a way to influence or change government practices. Some business associations are organized, but business people are not used to initiating collective action through voluntary activities. Neither the executive nor the legislative branches are easy to approach, and most legislation is made without extensive or effective public comment.

Laws – when passed – are poorly enforced, and the court system is inadequately staffed to enforce either new or existing legislation and regulation. Some progress is being made in defining private property and in improving contract law, however, and there is an agenda of laws to be passed to improve the “enabling environment” for business. Government still perceives smaller businesses as insignificant in their own right, but useful in the allocation of scarce resources to solve regional problems or unemployment problems.

Some business people are now generating large profits, and competition in the market is changing. There is a class of marginal owner-operated businesses which

grows larger as the government progresses in privatizing state-owned enterprises. Most of the privatized enterprises find it necessary to downsize this workforce in order to have any chance of becoming competitive in the marketplace. Many of the released workers are unemployed or move into subsistence activities in the shadow economy.

A few of the larger private enterprises approach government officials seeking protection from market competition. Bribery is added to the extortion practiced by some officials. Organized crime “protection” continues to be an extralegal tax on businesses, but the price of protection stabilizes as the criminal element learns how much can be safely extorted without killing the companies being protected.<sup>6</sup>

More successful businesses are seeking and finding competent business services, initially produced by foreign consulting firms, but more and more featuring local analysts trained in foreign settings. Small and micro businesses for the most part cannot afford access to these consultants, and find no subsidized services provided by either local or national government organizations; they still rely on foreign funded programs for technical assistance and training.

Some banking organizations are developing with both an interest and a capability for making loans to smaller businesses, but funds are generally insufficient to meet most requests. The state is attempting to improve banking regulation and supervision, but is handicapped by a lack of trained individuals to act as teachers. There is much talk of the state providing the banks with subsidized loan funds for smaller businesses – and this proposition has some support in government and parliament. Non-bank financing is becoming available to enterprises, some of it in the absence of a clear legal framework to support such types of financing.

### 2.3 Stage Three – Formation of Functional (Competitive) Markets

Markets are operating much better at this stage. More businesses have experience with failure as well as success, and the barriers to entry have been reduced, or at least they are more transparent to the entrepreneur. Businesses accept that they must compete, but also realize that they must also cooperate with their peers to counter government’s attempts to impose undue transaction costs on the private sector. Entrepreneurs are more aware of their responsibilities to the local community, and how their “public image” can have a positive impact on their profits. Businesses also know and respect their customers, and realize that they must continue to produce quality goods and services so that they don’t lose – but hopefully gain – market share. Professional standards are developed and incorporated as part of best practices in conducting business. Foreign trade and investment relations are expanding. Market information is available in a timely fashion.

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<sup>6</sup> Put another way, organized crime attempts to find the rate of extortion that maximizes income. Since the Mafia is a monopoly, the level of output is lower and prices of goods and services are higher, than they would be in competitive markets.

A wide range of services is available to business owners and managers that can help their enterprises expand and/or become more profitable. Businesses realize that they can't afford to house all of their technical and managerial needs on a full-time basis, so they make conscious cost/management decisions to hire such services when needed. Management consulting, accounting, advertising, transport, equipment leasing firms, to mention a few, are serving more and more enterprises, particularly small and medium sized.

In many locations, micro-businesses (which typically can't afford to pay full rates for management consulting) are able to get needed – at least minimum – advice and training from local organizations sponsored in part by government, corporations, or donors. Local universities are involved, too, in outreach programs to new entrepreneurs and micro-businesses.

***At Stage Three, more businesses have experience with failure as well as success, and the barriers to entry have been reduced, or at least they are more transparent to the entrepreneur.***

Many types of financing are available. Banks are lending to meet both short-and long-term capital requirements of medium and small businesses. (Microenterprises may still face difficulty in getting formal financing, however, and must rely on publicly sponsored programs.) Capital markets are playing an important role in attracting investment in small and medium sized businesses. Many classes of investors – foreign and domestic – are putting their money into local enterprises.

Government now views private enterprise and private ownership as important building blocks for economic growth, trade, and investment. Parliament meets with business constituents and their representatives (associations, lobbyists, etc.) to discuss businesses' needs and concerns. Numerous "feedback loops" for exchanging information between the public and private sector stakeholders exist, and are utilized. Taxes, licensing, and other fees are not onerous. As a result, most businesses – small and micro included – operate in the formal economy. The public also has an understanding of market economy, competition in the marketplace and the role of privately owned businesses (of all sizes) in generating jobs and wealth for citizens and the nation.

The government is also conducting itself as a regulator of the market economy, rather than a controller of productive resources. The government is better able to enforce a "rule of law" that benefits business and consumers in several ways. Public corruption is less common, and violators are prosecuted. Courts are equipped to process commercial cases in a timely fashion and organized crime is being reined in, and small businesses no longer have to pay local "protection" fees.

## 2.4 Final Objective and the USAID Legacy to Sustain the Transition

### *The “Leave Behind” Once the Stages are Completed*

The end objective for USAID’s work represents the stage at which the local institutions and internal processes are in place to sustain continued functioning of the marketplace. By “internal processes” we mean essentially that:

- Private businesses can represent themselves in the debate with government about building a better business environment.
- Consumers understand the workings of a market economy, they know their rights, and they express their preferences by making choices in the marketplace that in turn affect the commercial viability of businesses.
- The different branches of government and various ministries are also debating among themselves how to use public budget to promote market-led growth in the economy.
- Information about the marketplace is available and is being used to make better investment decisions.

The efficient workings of these processes of course depends on the presence of various organizations and institutions that serve private enterprise development objectives. For example:

- Businesses of all sizes must have access to a range of financial products to meet their need for capital.
- Trade and professional associations must be responsive to and supportive of the needs of their members.
- Training and/or academic institutions should have curriculum offerings that help entrepreneurs of all types and at all stages – from the beginnings of a business plan or concept to higher degrees in finance, management and economics.
- A business services sector – including consulting services – should be helping enterprises in becoming more profitable and in expanding their markets when desired.
- Local and national level government agencies should be helping to regulate a fair and open marketplace that encourages private investment and entrepreneurship, rather than controlling productive assets as was the case under the former socialist system.



## *Building a Legacy of Sustainable Partnerships for Enterprise Development*

These organizations and institutions, and the new ways in which they interact to promote a market-based economy, form the basis for what USAID has termed “sustainable partnerships” for enterprise development. Partnership implies an agreement between two or more parties for the purpose of achieving a common objective. The stages of enterprise development model focuses on the critical role that these new partnerships will play. It is not enough to give technical assistance to businesses: we must promote the local capacity to deliver services once USAID is gone. It isn’t enough to set up loan fund that will help only a few businesses: we must build the local capacity to provide a range of financial services on a commercial basis. It isn’t enough to advise government on how to change laws and policies: we must strengthen the ability of private business groups to rationalize and articulate their demands to the government, and the sense of accountability that government has in responding to those needs in the interest of economic development.

USAID’s legacy will be these sustainable partnerships, characterized by the people, organizations, and institutions in both the public and private sector that have adopted new, transparent practices of working together for continued improvements in the marketplace. This legacy will also be characterized by greater exchanges in the region – East-East trade and information exchange – as well as increases in the commercial relations between the region and the US and other developed economies.

This legacy includes both the principles of market economics as well as those of a democratic society. The “legacy mechanisms” described in Section 1.2 will build on the gains made by USAID country-level programs, and support continued improvements in the economy and the enabling environment that will benefit businesses, and ultimately consumers.

### 3. Strategic Program Areas and Lessons Learned for Sustainable Enterprise Development

#### 3.1 Six Program Areas that Form the Basis of USAID's Strategy

Based on discussions with partners and a review of lessons learned after nearly a decade of working in the region, USAID has identified six areas that are important to promoting sustainable private enterprise development. The objectives for each of these are briefly described below, followed by a presentation of lessons learned over the past decade.

##### *Legal and Regulatory Reform*

Legal and regulatory reform is a major requirement for successful private enterprise development. Governments must recognize the right of citizens to own and transact property, and it must establish a legal framework and a rule of law that allows market incentives to promote economic growth. To the extent that private ownership and contract law are not well defined or properly enforced, market transactions will be hindered. This includes the need to develop a functioning real estate market that allows these assets to be used by businesses as collateral. Onerous registration requirements and extensive licensing requirements also hinder new start-up enterprises.

***The process of policy change and implementation is just as important as the policy outcomes themselves.***

To support the formation of a developed marketplace for goods and services, any laws related to property ownership or commercial contracts should do at least two things. One is that they should help in making markets competitive. Competitive markets will promote more and better quality goods and services for consumers, domestic and foreign.

The second is that they should minimize the transaction costs in the economy. High transaction costs and high levels of taxation (particularly taxes related to labor) are a major reason why so many ENI businesses are operating underground at present.

In a developed market economy, therefore, laws and regulations that promote competition and reduce transaction costs will be in place. Also, the government will have the ability to enforce a "rule of law" which allows the marketplace to function properly and checks the negative impacts of organized crime. We must recognize that although passing legislation is an important step, it is itself not sufficient. Only when enabling laws and regulations are implemented will investors and entrepreneurs gain greater confidence in the market economy.

The process of policy change and implementation is just as important as the policy outcomes themselves. USAID's experience has amply demonstrated that participation by stakeholders – those affected by policy decisions – leads to better

policy choices, and better implementation of those choices. Under the old system of central planning and single-party politics, citizens had no say in how the state would operate. Now their involvement is crucial not only because of the fundamental need to advance the principals and institutions of democracy, but also because they have the right to own and sell property and to manage economic activities that will help themselves, their employees, and their communities. Another important goal, therefore, is to establish transparent legislative procedures, and promote representation by the business community in the policy-making process.

In general, the major contribution that can be made to productive micro, small and medium sized businesses is the removal of barriers – many of them related to government rules and regulations – which inhibit the startup and growth of smaller enterprises. Most small startups are begun with the owner's personal funds or with money borrowed from friends and relatives. Most of the expansion of smaller enterprises can be financed by retained earnings, providing that government taxation or extra-legal taxation through corruption or through organized crime does not take all of the profit generated in successful smaller enterprises. An effective legal structure with good dispute resolution and enforcement mechanisms, and improved rule making and government regulation developed through open discussion with business associations can strengthen growth possibilities in the small business sector.

### *Association Development*

Trade and professional associations provide valuable services to their members. The majority of USAID's partners regard them as vital to lobbying the government on economic reforms that will create an enabling environment for private enterprises in the ENI region. Depending on their capacity and member demand, they can also provide other information or training services that strengthen their industry and their members.

Under the former communist system, collective actions were an extension of the state's authority over society. Individuals were not allowed the right to assemble or to organize for a common cause that was important to them as private citizens. This legacy made it difficult in most ENI countries to teach the value of associations to entrepreneurs in the early part of the decade. However, within a few years many businesses realized that they needed to organize to protect their interests. The ongoing challenge is to educate association managers and members in new principles of participation, for example volunteerism, the value of being a paying member, and techniques for lobbying government collectively to demand changes that will help both the community of enterprises, as well as individual businesses.

The importance, then, of associations is not only in the services that they can bring to members – general market information, advice on licensing/registration within their industry group, networking opportunities, and training – but in their ability to organize an advocacy agenda and demand legal changes necessary for a market economy. As the market economy develops in ENI, we expect to see associations that are

effectively representing the interests of their industry and their members.<sup>7</sup> In addition, we expect that they will be self-sustaining through member fees and/or revenues from value-added services to the industry.

### *Technical Assistance to Enterprises*

The goal of programs supporting technical assistance to enterprises is to help business owners develop the skills and knowledge necessary to manage their operations. In particular, businesses need to learn how to control costs and operate efficiently in order to increase their chances of survival and/or success.

Whereas much of the assistance that enterprises receive in the early stages has been provided through foreign experts, over time this must be substituted with local experts. After foreign donors depart, businesses will still need expert advice from time to time to maintain or expand their competitive position. However, as the marketplace becomes better developed, small and medium sized enterprises will be buying services on the local marketplace to improve their business.

Entrepreneurs in the region are continually stressing the need for information about markets, services, finance and foreign investors. At advanced stages of enterprise development, market information will be available, timely and reliable. Some of this information may be provided through public programs or commercial offices, whereas some will be available as a service for a fee.

TA for microenterprises is a bit more problematic.<sup>8</sup> Even in developed economies training/TA for this class of enterprises has some public funding because governments – at all levels – have found that teaching microentrepreneurs business management skills produces a high rate of return on use of public funds. The same will be true for micros in ENI. Even in advanced stages of market development, other sources of funding will need to be identified to continue some level of assistance to this class of entrepreneurs, because they are vital to employment creation and income generation.

### *Financial Services*

There are numerous factors affecting the availability of financing, many of them macro-economic in nature. One reason, for example, that business have to go to lenders or outside investors for financing is that they must pay exorbitant taxes to be “legal” under the current system. This draws capital away that could be re-invested in the enterprise.

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<sup>7</sup> There is a good linkage in this regard to USAID democracy and governance objectives. See for example the report entitled “Mobilizing Community Resources for Local Economic Development,” a report on a regional conference held in Bucharest, Romania in November 1998.

<sup>8</sup> The definition of microenterprise used here is like that used in other parts of the world: businesses employing ten or fewer workers.

The lack of legislation and/or enforcement in banking reform, laws on competition, collateral law, bankruptcy law, and others have similar negative effects on access to capital for business expansion. Banks operating in a high-inflation environment cannot pay sufficient interest on deposits to mobilize savings and provide capital for investment in the private sector. These macro level issues are important problems to be addressed in programs that deal with legal/regulatory reform, but their inter-relatedness to financial issues cannot be overlooked.

At the micro level, lenders, investors, and the businesses that benefit from financing need to learn how to use financial services responsibly. As the markets improve, businesses should have access to a range of products – debt, equity, savings and insurance – that help them to start, operate and grow their enterprises. Competition in the marketplace for financial services is an important objective. There are additional problems with agriculture finance – such as seasonality and risk of crop failure – that require specialized skills, training, and institutions.

### *Educating the New Generation of Entrepreneurs and Policy Makers*

The development of human resources must be a top priority for bringing the former communist countries into the global market economy. Although the workforce in the ENI region received adequate technical training under the former system, training in principals of modern business management and market economics was lacking. The result has been seen time and again in, for example, privatized enterprises that have good technology, but not the management skills to market their products or to reduce costs in order to become competitive.

Similar problems exist among governmental bodies responsible for the passage and implementation of economic reforms. Many elected officials see only the short-term cost of reforms, and therefore opt to reinstate some form of socialist order, or at best to stall on reforms hoping that a less painful solution will present itself.

USAID considers training for the younger generation of male and female entrepreneurs and public officials as an important priority for realizing the transition to a market economy. This does not categorically rule out the relevance of middle-aged and older entrepreneurs, but it will serve to focus USAID's resources for training and education on a target audience that will shape the future of business – and politics – in the region.

Our goal is greater understanding among the public, the government, as well as businesses, about how a market economy operates and about the benefits it brings. Beyond this understanding, we hope that the majority of citizens will favor such a system over the previous system dominated by communist politics and planned production economics. Private business will be a positive element in society, and entrepreneurship will be a valued characteristic. School curriculums at the secondary and higher levels will provide training on how a market economy operates, and how businesses serve to improve the quality of life in the society.

## *Privatization*

Privatization of productive resources – including land as well as state-owned enterprises – is a pre-condition for a functioning (competitive) marketplace. However the full benefit of privatization and competition can only become manifest when businesses are operated for the long-term benefit of shareholders rather than managers. Too often, privatization has led to control by a few individuals who are more committed to using the assets for short-term profits rather than investing in the long-term development of the firm. Overt managerial abuse must be curbed through better corporate governance practices (effective charters, functioning oversight, disclosure and reporting procedures) and through the establishment of an environment which allows managers to benefit from pursuing long-term business improvement strategies.

Also, completing the process of privatization has been stalled in many ENI countries by the lack of political will among elected officials and the government administration, as well as by the challenges inherent in selling larger and often more problematic enterprises. USAID, the IMF, the World Bank, other donors and the local business community must continue to pressure governments until they follow through on privatization. At the same time, support should be provided to assist committed governments to develop processes and procedures to divest of problematic companies – many of which have failed at privatization but for political reasons are difficult to liquidate.

USAID's goal is the transfer of enterprise assets from state control into private ownership. In a competitive marketplace, capital markets will be in place to facilitate investment in businesses that operate according to principals of good corporate governance. The major share of GDP will be generated by privately owned enterprises.

Without clear commitment on the part of governments to complete privatization and enforce good corporate governance principals, USAID assistance to privatizing enterprises is unwarranted and should be stopped. The focus should be on privately owned enterprises that want assistance and are willing to make tough management decisions to become competitive. Also, assistance should be denied to privatized entities that do not practice good corporate governance. These are tough positions to take, but they must be taken so that USAID's limited resources go towards the critical issues of promoting the will to complete reforms, and assisting enterprises that use good business practices.<sup>9</sup>

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<sup>9</sup> "Corporate governance refers to that blend of law, regulation and appropriate voluntary private sector practices which enable the corporation to attract financial and human capital, perform efficiently, and thereby perpetuate itself by generating long-term economic value for its shareholders, while respecting the interests of stakeholders and society as a whole. The principal characteristics of effective corporate governance are: transparency (disclosure of relevant financial and operational information and internal processes of management oversight and control); protection and enforceability of the rights and prerogatives of all shareholders; and, directors capable of independently approving the corporation's strategy and major business plans and decisions, and of independently hiring management, monitoring

## 3.2 Lessons Learned

### *Legal and Regulatory Reforms*

***In many cases, politicians and civil servants lack the political will to implement reforms that would demand short-term sacrifice for long-term benefit.*** The public is not demanding reform; they are demanding jobs and a better standard of living. This makes it difficult for parliamentarians to agree upon a course that is in the best interest of the society. Short-term suffering for longer-term gain is hardly attractive, particularly when the economic outlook is already dismal. As time goes on, however, industrial capacity continues to deteriorate, and economic activity remains in the gray market with little promise for advancement. While parliament debates the pros and cons of capitalism and socialism, business continues to suffer. The list of laws and regulations needing to be addressed is long, underscoring the daunting nature of the challenges to instituting a market economy. The way to overcome this obstacle is through continuing education of decision-makers about the workings of a market economy, and by promoting dialog between public officials, entrepreneurs, business groups and associations.

***Even where laws may be passed, governments must do more to implement and enforce enabling laws and regulations if a market economy is to emerge.*** This is one of the most significant obstacles to completing economic reform. Many programs are currently focused on getting laws passed, which, while they are important, are threatened by governments' weak enforcement ability. This capacity is undermined by not only a weak judicial system, but also by corrupt practices of some civil servants that abuse their position to enhance personal incomes. Implementing a rule of law that benefits the economy demands, therefore, that the government embrace judicial reform and anti-corruption as topmost priorities, and to reflect these priorities in the public budget.<sup>10</sup>

***Many citizens as well are unfamiliar with the workings of a market economy and why private enterprise is important for economic growth.*** Demand by the consuming public for economic reform will help push policy makers to implement important legal changes. However, the public needs better information about how incentives work in a market economy, and how they stand to benefit from a growing private enterprise sector. There is an important strategic role for the media in public education programs about economic reform, entrepreneurship and good business practices.

***Private enterprises themselves are the most important advocates for reform, but many public officials don't recognize them as a viable constituency.*** Business associations, think tanks, and other NGOs can help "put a face" on

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management's performance and integrity, and replacing management when necessary." From the World Bank Corporate Governance Home Page, <http://www.worldbank.org/html/fpd/privatesector/cg/>.

<sup>10</sup> Corruption is an important topic for USAID as well as other donors working in the region. Additional information about efforts in this area can be found <http://www.nobribes.org>.

business so that parliamentarians and other government officials recognize the existence of private enterprise as an important vehicle for economic growth in the country. USAID and their partners should support business surveys to help bring issues to the attention of decision makers – and the public at large – so that there can be a productive debate about reforms.

***The negative effects of corruption and organized crime on business should be discussed openly among stakeholders in government and business.*** These are the most visible manifestations of a weak rule of law and can only be overcome through awareness and enforcement. However, until governments can afford the cost of enforcement, this will remain a problem.

***Transparency in the legislative drafting process will help promote dialog and create better understanding of mutual interest among public and private sector stakeholders.*** Governments should open their drafting committees to involvement by think tanks, policy experts, associations and coalitions. This will engender dialog and promote focus on areas of common interest. USAID programs can facilitate this process with expertise and other resources, but they should take a “back seat” role. USAID implementers need to promote linkages among key institutions, and not be seen as aligned with any single actor. This approach will enable local institutions to find new productive ways of relating to each other that will help sustain the change process beyond the presence of foreign advisors.

***There are several partners outside of government that should be tapped for promoting legal reforms.*** USAID’s global experience amply demonstrates the importance of a “bottom-up” or “demand-driven” approach to policy reform and legal change. In a classic “foreign expert” model, foreign advisor explains to policy makers the rationale for any given reform, and provides policy analysis research and reports to substantiate the advice given. In the policy dialog model, the strategy is to strengthen the capacity of local experts and local stakeholders to analyze and advocate for reforms. The goal is the policy outcome, but it is also the establishment of a dialog among government and citizens, in this case the business community. Private sector groups that are instrumental in putting pressure on government to complete economic reforms include business associations, coalitions, associations of cities/mayors (because of their interest in controlling locally-generated public revenues and in attracting investment) and other NGOs promoting civil society. University groups, think tanks or other local policy experts can also be useful by developing good analytical information to feed the policy debate.

***Although major economic reforms are a national level agenda, there is increasing evidence that work at the local level can be a catalyst for reform as well.*** USAID and its partners should cooperate with progressive minded district-level and municipal officials and business leaders. Work at this level can add impetus too to national initiatives to improve trade, investment, and the enabling environment for private enterprise development. Community development efforts that feature partnerships between local governments and businesses can produce more tangible results, and demonstrate how government can promote business, and how business



can improve the community. Out-of-country training – for example in US small towns and cities – for local officials and business leaders can be used effectively to demonstrate how to stimulate community investment and enterprise development.

### *Trade and Professional Business Associations*

***Trade and other types of professional business associations are important partner institutions for promoting private enterprises in the 21<sup>st</sup> century.*** In the early stages of the transition to a market economy, business managers are focusing on their own survival, and have little time or interest in collaborating with their peers/competitors to advance their particular industry. Having lived under a socialist system, they want to express their independence, not collective action. However, many now realize the value of associations, both to promote their industry, and to push for legal reforms that will create more opportunities for their business ventures. In many cases, women's business associations have been important for the success of women entrepreneurs. Their usefulness depends on the sector (e.g., manufacturing vs. construction) and on the maturity of the business (e.g., entry level vs. well-established), but the many positive examples in the region indicate that their development is important.

***Associations must however be member driven and not funded into existence by USAID.*** Heavy subsidization of operational costs of associations is not warranted. Training to help improve association management, however, is. Direct donor funding can have the effect of turning management's attention away from members' interests and towards budget survival strategies. USAID and its partners need to nurture existing associations – even the very nascent groups – that demonstrate the skill and attitude to represent their industry and their members. Membership should be voluntary, not mandatory, meaning that the association should be able to recruit and retain members by providing value-added services. In this regard, it is important that USAID and its implementing partners have good criteria for selecting associations that have some existing capacity, as well as future potential, to work with. Many associations exist only on paper, and these should of course be avoided.

***Associations are strategic partners in our effort to reform laws and regulations that impede the existence of a competitive marketplace for businesses of all sizes.*** Association staff should be taught the skills of advocacy, including the skill of educating members about what laws need to be reformed, and why reforming them will help the business community. The association's outreach must be to policy makers as well as their members. Associations can serve an important brokering role of bringing private and public sector stakeholders together to discuss constraints to enterprise growth and ways to overcome them.

***Associations are strategic partners also in promoting regional trade and information networks, lessons learned and best practices.*** Because of their member base, associations can help to leverage regional initiatives so that they directly reach the business community. Businesses looking for buyers or joint-venture partners in other countries need to tap into a reliable network of information on local

enterprises that can be provided by associations. Regional trade shows are another venue that can be facilitated by trade associations serving specific industry groups. In addition, building a region-wide coalition of associations to lobby governments on policy reforms to promote better commercial relations across countries is another effective tool for strengthening linkages in the region. Associations will play an important role as USAID phases out of country level programs and explores regional initiatives that will sustain the transition towards a market economy and growth of the private enterprise sector.

***However, it is important not to dilute the industry- or sector-representation role of associations by expecting them to serve as consulting organizations.*** The most important function of associations, particularly at this stage in the transition to a market economy, is to promote their members' interests, broadly speaking. It is a natural inclination of many new associations to find revenue-generating activities that will help their budget. These inclinations typically lead them to training and consulting services. In addition to this distracting from their advocacy role, it has also been shown that they are not as well equipped to provide these services as local consulting or training organizations. For these reasons, associations should stick with the basics of advocacy, information, networking, trade shows and the like, certainly before considering moving into more specialized areas.

#### *Technical Assistance for Enterprises*

***Business Support Organizations (BSOs) cannot be commercially viable by serving only the micro and small enterprise sector.*** However, there is a great deal that can be done to recover some costs and thereby offset dependence on donor subsidy. Full service fees can be afforded by medium sized businesses, but not by smaller and micro sized businesses, typically. Although subsidies may be necessary for advisory services that improve the management systems of a small business, other areas such as accounting or legal services can be provided on a zero-subsidy commercial basis, even to micro-businesses. Good lessons have been learned about other revenue generating strategies for BSOs in some countries such as Poland that can be applied by their counterparts in the region.

***A combination of fees and subsidies is needed for BSOs to continue serving the micro and small enterprise sectors.*** Reliance on USAID funding should be replaced by partnerships with local governments, or support from large enterprises (local or foreign) in the community. Other viable options need to be explored and promoted to BSOs working in the region. BSOs need to operate like a business, continually adapting their product lines and services to the marketplace. It is also important that BSOs develop a mix of clients – by size and industry – so that they are diverse enough to withstand variances in the marketplace, which is still too small for too much specialization in the services sector.

***Microenterprises typically need only basic information about running a business.*** It's important to develop low-cost techniques for delivering the basics to as many interested entrepreneurs as possible – classroom training, self-directed

teaching, manuals and the like. As businesses grow their needs become more complex, and one-on-one consulting services are more justifiable. Some basic counseling services for potential and early stage business owners are critical to help them understand the nature of the problems they will encounter, and techniques best suited to solving those problems. Counseling helps develop the skills and knowledge needed for problem identification and problem solving, whereas consulting works to directly solve a problem *for* the client. BSOs that develop counseling services and training modules can help many potential or early stage entrepreneurs make more effective decisions about how or whether to start their business. Such programs can be given to large numbers of clients, and help increase the exposure of the BSO to the local marketplace.

***Direct firm level assistance provided by foreign experts is critical in the early stages of the transition; but over time this must be replaced by local expert services.*** Firm level TA programs must include an explicit component for training local service providers, such as independent consultants, staff of BSOs or university business school faculty. Foreign technical and business management experts must work with local professionals to teach them the tools of the trade. Donor funded programs in the field should use local professionals for services whenever possible as well. Development of “East-East” linkages that draws on regional expertise should also be a priority.

***Technical assistance is a critical element for ensuring good performance of loans provided to or investments made in an enterprise.*** Although TA and finance should not be linked into a single program, they are important services for a business which, when used in consort, can produce a better result in terms of enterprise performance and profitability. They are complementary tools that can help to improve the competitiveness and profitability of enterprises. The provision of these services, however, should be performed by different organizations to maintain objectivity. TA program managers must become fully aware of all financial service options available to their clients, and vice versa.

***Business associations, though they provide valuable member services, are not well equipped to provide consulting services.*** Associations play a critical role as industry advocates, but their ability to provide training and technical assistance to business has not been demonstrated. It's more important for them to focus on advancing the sector they serve, promoting high standards of excellence in the industry, or linking members with each other, and with potential markets for their goods or services. Specific consulting services should be left to commercial firms serving the local market. More developed associations can, however, provide some invaluable fee-based services to members such as information, publications, and industry studies where appropriate.

***Promoting good corporate governance remains an important objective for our work in the region, at all stages of the transition to an open market economy.*** In addition to political will, the lack of good corporate governance is a major impediment to completing privatization. As a general rule, USAID should not waste its TA and

training resources on firms that do not have good corporate governance structures in place. Those that are fence sitting should of course be encouraged to replace old-line relationships and unhealthy vested interests with a good board and a strong management team that will be responsible to shareholders. Even for new smaller enterprises that do not exhibit characteristics of poor corporate governance, it is still important for TA to address this issue and its relationship to bottom line profitability and future viability of the enterprise. Just as important is the promotion of business ethics, community service, respect for consumer rights, and value of legal/regulatory reform for economic growth. To become viable players in the regional and global marketplace, countries must replace cronyism with market incentives and competition. The promotion of corporate governance by entrepreneurs, BSO managers, and trade association leaders underscores the value of business not only to the economy, but also to the emerging, post-communist societies.

### *Financial Services*

***The most important prerequisite for creating a viable financial services sector is a legal and regulatory framework that promotes competition, investment, and market expansion.*** The structures for banking must be strengthened, but these efforts will have little impact without the legal and regulatory framework that promotes investment. Pushing reform is the topmost priority for attracting investment and lending capital. Many banks in their present state are difficult to work with because they have a limited capital base, and restrictive rules for lending. However, where progressive banks exist, USAID and its partners should try to bolster their credit operations – particularly long-term capital investments – to demonstrate the value of good lending, and get whatever capital is available into the hands of promising entrepreneurs.

***Many firms don't necessarily need financing, but if they do, they almost always need accompanying TA to perform on the loan.*** This is less true in micro credit area, where the global experience has amply demonstrated that microenterprise owners can repay and continue borrowing with minimal training or technical assistance. As businesses become larger and have greater capital requirements, TA and training become more critical.

***Non-bank financial services should be introduced early in the transition, and promoted throughout the stages of enterprise development.*** The lack of enabling legislation for credit unions and other non-bank services can be a constraint, but more often than not, non-bank credit strategies can be introduced because there is no specific legislation preventing such programs. The legal framework needs to be addressed, but it does not impede efforts to introduce small credit facilities such as credit cooperatives or microfinance schemes that teach the basics of good lending and borrowing. Larger financial assistance programs can include leasing or equity financing. Over time these credit and investment strategies will promote competition in the marketplace, and encourage local institutions to broaden their range of services to meet the capital requirements of micro, small and medium sized businesses.

***Microfinance loans from a couple hundred to a couple thousand dollars can reach the smallest of businesses to help meet the economic needs of entrepreneurs and their families living near the poverty line.*** Because of the uncertain economic environment, banks are biased towards larger, shorter-term loans. Like in many countries around the world, countries in the ENI region do not have the laws or regulatory framework in place to support full-service savings and lending facilities for micro-entrepreneurs. This topic should be included in the list of legal and regulatory impediments to enterprise growth. Legalization and regulation of savings and lending facilities for micro-entrepreneurs is needed so that they can leverage their capital base and expand their outreach to this class of entrepreneurs. In the meantime, USAID can support micro-credit schemes in spite of current legal framework. USAID's global experience in this area can help in building a program based on best practices in the ENI region.

### *Educating the Next Generation of Entrepreneurs and Managers*

***Training for young entrepreneurs and the next generation of public decision-makers is vital for completing the transition, and sustaining a viable market economy over time.*** Although successful entrepreneurs of any age are important role models, their skills and their successes must be demonstrated to tomorrow's business managers. Many in the present leadership are still reluctant to undergo reforms. Training youth will help increase the demand for reform over the next critical period in which difficult choices must be made if the political-economy is to alter substantially. Sustainability of changes in the legal framework and the business ethic, once made, also rests heavily on the new generation of entrepreneurs and decision-makers.

***Because of budget crises, many academic institutions are suffering in scope and quality of their teaching; yet, they are important institutions for the future of the economy and must be assisted.*** Support to their MBA programs is vital, and should be linked into the local business community as well.<sup>11</sup> Wherever feasible, USAID and its partners should strengthen the knowledge and the teaching techniques of business faculty. Linkages with American academic institutions and professor exchange programs are important approaches and should be continued. Just as important is creating linkages between business faculty and local entrepreneurs to make training relevant to local conditions, and to create on-the-job learning opportunities for MBA students.

***Use the media to educate the public at large about the importance of private enterprise to a successful market economy.*** Public support for creating an open-market economy is critical for future growth of private enterprises, let alone the economy as a whole. Use of the media to educate and inform the public, and influence policy reforms, will help to leverage opportunities for the business sector.

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<sup>11</sup> Degree programs in business administration, finance and economics are important, but USAID does not have the budgetary resources to directly fund them in a major way.

Where an independent media exists, use of their services should be integrated into USAID's private enterprise development strategy.

### *Privatization*

***Privatization is essential, but the returns to donor investment in this field are greatest in the earlier stages of enterprise development.*** Completing privatization depends heavily on the political will of governments, which oftentimes is lacking and in some cases even dwindling as countries approach the 21<sup>st</sup> century. Technical assistance to establish the mechanisms for privatization, value state enterprises for sale, and advise on specific deals is most effective in the early stages of the transition. But at this point, forward momentum depends on the government instituting rules for fair and open competition that will allow the market to operate, and making the decision to let go of non-productive state assets. Most privatization issues can be integrated now into USAID's broader agenda for legal and regulatory reform intended to benefit all businesses. USAID may conclude privatization of "strategic" companies in those cases where limited resources can leverage significant results. Continued and increased attention must be given to instituting rules of fair and open competition that will allow the market to operate.

***Weak managerial accountability and poor corporate governance practices are major obstacles to reaping the benefits of privatization.*** Governments must legislate and enforce corporate governance in order to protect the interests of shareholders, and increase the confidence of foreign investors. Public corporations must adopt charters requiring disclosure, effective oversight and periodic and accurate financial reporting. Shareholders must understand and be able to exercise their ownership interests. Privatized entities that do not have policies and procedures for corporate governance in place should not receive US technical assistance.

### 3.3 Sectoral and Cross-Cutting Issues

***In many locations in the region, men and women do not have equal access to the means of production, or equal treatment under laws and practices governing commerce.*** Women entrepreneurs as a class have less access to capital, services, and other means of production than do male entrepreneurs. In addition, some laws and regulations governing private ownership of property favor men. Although some of these laws are being revised, there is still much work to be done to ensure that even gender-neutral laws are applied in an unbiased fashion. Although correcting gender-bias is itself an important principal for USAID, there is ample evidence to suggest that female entrepreneurs are contributing significantly to economic development throughout the ENI region, and could contribute more if given equal treatment under the law. Ensuring equal access to USAID program resources is a must.

***Growth potential in an industrial sector is one, but not the only, variable in selecting where to target assistance.*** Although each country in the region may

have its unique comparative advantage for economic growth over time, many industrial sectors undergoing restructuring are at early stages of market development and it may not be obvious which will come out as the economic leaders. (This becomes less true as markets begin to emerge and take shape along with progress in the transition.) Priority, of course, should be given to businesses that are operating in a growing marketplace. But, the room for expansion is so great that more than enough sectors or sub-sectors warrant assistance. The main criteria should be focused on identifying the potential of the individual enterprise being considered for assistance.

***However, given the release of pent-up consumer demand for better quality food products, one area of potential growth common to the region is agribusiness and related food processing and marketing industries.*** USAID's long experience and skill in agriculture and agribusiness development are appropriate to many countries because there is still a fundamental need to increase food production both for domestic and regional markets. Poor policies and government intervention have had a particularly deleterious impact on agricultural production in the ENI region. Still, there are significant opportunities in agribusiness that fit well into USAID's enterprise development strategy. Of course, the agribusiness potential is greater in areas where gains are being made in the efficiency of agricultural production. Whereas in the past agriculture and agribusiness programs were managed separately in the USAID structure, it is important that they be integrated and given fair attention alongside other enterprises as USAID implements its strategy in the region.

***USAID partners should pursue linkages between enterprises in ENI and US commercial interests more aggressively than was practiced in the past.*** USAID enterprise development funds can be effective in leveraging US private sector involvement. This area hasn't been explored as yet, but deserves greater attention as USAID's immediate presence begins to wind down in the region. Having a foreign partner is a more effective incentive for ENI businesses to restructure than is US foreign assistance. USAID can be a facilitator in helping bring interested parties to the table. Commercial relationships with American businesses will help enterprises in the region. After foreign aid withdraws, in its place there must be viable opportunities for trade with and investment from international businesses. Even though many of the businesses in ENI assisted by USAID programs aren't likely to be immediately attractive to US commercial interests, some are and more will be over time. We should encourage good opportunities for partnering with US businesses, letting them benefit from the information USAID and its partners have about the investment climate, promising sectors, and promising enterprises.

***A plan for sustainability of program benefits must be designed into all USAID activities at an early stage.*** The lessons of the transition to date have taught us the importance of strategizing beyond a short-term timeframe. For example, we can assist enterprises now with US expertise, but who will assist them when donor funds cease? We can provide some financing to businesses, but where will future businesses get financing? We can advise the government on policy reforms, but who

will pressure them to continue the reform process once our experts have left? New – and for that matter existing – programs must be assessed in terms of their relevance to creating sustainable factors for enterprise development and economic growth.



## 4. Adapting Strategic Program Areas to the Stages of Enterprise Development

### 4.1 Overview

The lessons learned that are presented in the previous chapter reflect ten years of experience in the region. They are important background information for understanding why programs must be adapted to local conditions, and must seek to strengthen local capacities, local organizations, and new institutional relationships in order to encourage competitive, well-functioning markets for enterprises.

To be effective, USAID's programs must be adapted to the particular conditions of a country. Missions and their partners will select which programs to pursue using a diagnostic review of local conditions, and a review of other donor activities. Although the ENI nations have similar challenges to creating a market economy, unique local conditions require USAID and its partners to modify their strategy so that development interventions will leverage local initiative and promote the rapid introduction of new techniques and practices. (A more complete discussion of these program strategies and lessons learned is presented in Section 4.2.)

***To be effective, USAID's programs must be adapted to the particular conditions of a country.***

Each of these program priorities contributes to two broad objectives for USAID's private enterprise development strategy in the region. One is to help businesses get the skills, tools and services necessary for them to improve their operations. Technical assistance, training, finance and associations aid this objective. The second is to help governments to establish and maintain an open and competitive marketplace for businesses. Legal and regulatory reform, advocacy (through associations, policy experts and other civic organizations), public education, training, and privatization are key elements to achieving this objective.

Contributing to these two objectives has direct impact on the success of the transition towards an open-market economy. But, each country is at a different stage in this process, and therefore requires a mix of program interventions that is appropriate to the needs of local enterprises. Furthermore, the structure and focus of programs must change as the local conditions for business improve.

### 4.2 Adapting Program Strategies to the Stages of Enterprise Development

USAID will utilize its program resources to move countries in the ENI region towards this third stage in which markets are functioning, and businesses of all sizes are able to compete. Country-level enterprise development strategies will be tailored to address the stages in each of the strategic program areas (legal/regulatory reform,

TA, associations, finance, training/education, and privatization). Ideally, USAID will phase out of a country once it has completed stage three. The reality, however, is that other factors may very well come into play – mandates from Congress and budget cuts for instance – that impact the timeframe.

Even if other factors reduce the ideal level of funding and shorten USAID's presence in a country, programs should still be designed using a diagnostic process that assesses the stages of enterprise development. An analysis of local conditions impacting on the strength of the business sector will help USAID and its partners to select their interventions more strategically, be more confident about results, and be better able to measure progress. Budget constraints may force USAID Missions to give up work in some areas. However, progress in any one or two of the strategic program areas is more useful than mediocre attempts to move ahead on all fronts. A diagnostic also can help determine where other donors or local organizations are operating in a complementary way to USAID's objectives.

As local markets develop, USAID's assistance programs will adapt to meet changing needs of the private sector. As needs change, so do opportunities for leveraging impact using foreign aid funds. USAID and its implementing partners must assess the local business environment on a regular basis to make sure that programs are not lagging behind initiatives or opportunities to promote a more rapid transition to a market economy. There are many variables and many local actors that influence how quickly an economy

***As local markets develop, USAID's assistance programs will adapt to meet changing needs of the private sector. As needs change, so do opportunities for leveraging impact using foreign aid funds.***

moves through the stages of enterprise development. It's of course presumptuous and ridiculous to believe that a single organization can orchestrate all the players neatly towards a common goal. However, with regular dialog among USAID staff, implementing partners, host-country counterparts, and the businesses we hope to assist, we can promote a common vision, and identify our differences.

The stages of enterprise development model will help to facilitate dialog about the local conditions shaping the marketplace. Part of this discussion will be about identifying what stage an economy is at. But, for USAID's purposes, a big part of the discussion must be on what to do – how to design and implement programs – at various stages so that resources move the host-country towards a sustainable market-based economy. Mission staff should closely monitor the private sector to identify areas where market based solutions are being developed independently of government and NGO intervention.

The following sections describe how program strategies will evolve between stages. These are broad-based descriptions, and must be fine-tuned within different country contexts. The common element to all of the programs, however, is orienting programs towards strengthening the institutions and human resources necessary to build better businesses and a better-functioning marketplace in which they can

compete. USAID funded programs – at whatever stage – must clearly address these objectives.

### *Legal and Regulatory Reforms*

**Stage One** should target public awareness training and education programs – in-country and abroad – at public officials, both elected and appointed. The aim is to give them as much exposure as possible to the workings of a market economy, the reforms that are necessary to establish it, and the nature of short-term costs and long term benefits to the society (political as well as economic). Where local resources are inadequate, several years worth of funding should be set aside to provide ongoing training programs in market economics and business for public officials. This training will need to be continued through stage two. At this stage it is also important to begin identifying potential partners, both individuals and organizations, that are receptive to new ideas and ways of doing things.

In most countries it is likely that little good information exists on the growing private economy (formal or informal). State statistical agencies are used to tracking only a small number of large enterprises, and lack the expertise and capability to track the rapidly increasing number of small enterprises. Such information is critical to a productive discussion on policy change. Expert training is available from statistical agencies in developed countries, and can be utilized to help develop local capability.

In addition to a survey of local enterprises, a baseline inventory of legislative and bureaucratic impediments to enterprise development and economic growth should be conducted. This should include a review of licensing and registration rules and procedures, customs requirements and tariffs, and taxation issues. This survey/inventory should be repeated annually, eventually by local experts. Legislators, in particular, need to be sensitized to the need to improve basic legislation, including contract law and property law, and to the need to simplify basic licensing and registration procedures. They must also be sensitized to the need to provide adequate funds so that government can measure economic activities in a rapidly changing environment.

In **Stage Two** training in legal reform will continue for public officials, including both government bureaucrats and legislators. The legislators should be sensitized to the dangers of overtaxing startup enterprises while cross subsidizing existing state owned enterprises that are operating at a loss. Training will be expanded to include private sector groups – essentially, the business constituencies of government. Legislators should be encouraged to make the legislative development process more transparent by providing more extensive and earlier notice of legislation being developed. The goal will be to bring private and public stakeholders together to discuss economic reforms, and to strengthen the demand for reforms coming from the business community.

At this stage, advocacy training will be given to associations. Also, funds will be used to engage local policy experts – think tanks, university faculty or independent experts

– to conduct analysis of policy constraints and solutions, and to facilitate public debate on reforms. These local experts can eventually take over responsibility for enterprise sector surveys and policy/legislative inventories.

**Stage Three** will see reduced funding going directly to train public officials and associations, but a continuation of support for policy analysis and dialog. For example, funds may be directed towards specific policy research projects, to pay local experts to comment on new legislative initiatives, or to offset costs of meetings of private and public sector stakeholders. Linking local interest groups into regional advocacy networks will also be a priority.

In stage three the legislature will have passed initial versions of all the necessary laws to establish a viable business growth environment. The stage will be marked by more extensive interaction with businesses and business associations to improve existing legislation and improve the supportive role of government institutions. Aid programs should emphasize the role of the government to lower transaction costs among businesses and between businesses and consumers.

### *Association Development*

At **Stage One** there are relatively few associations because entrepreneurs are not focusing on the need for collective action. Funding should go towards educating entrepreneurs and exposing them to the value of cooperating with their competitors to improve the marketplace that will eventually lead to better opportunities for their individual enterprise. Do not create associations at this stage, rather plant the idea and promote dialog among enterprises about common interests and the need for collective action.

**Stage Two** sees the emergence of associations, with varying degrees of expertise and capacity. USAID implementers should seek out the best qualified, and provide them with training and technical assistance in developing value added voluntary organizations. This training and technical assistance should include training in association management, membership development, advocacy, public relations, and coalition building. Association managers should be taught to develop and disseminate marketing information and techniques, identify best business technology and practices, and develop and promote standards of business conduct. In-country training and group study tours to the US are recommended. As the sector moves towards stage three, programs need to enhance the networking among associations locally, regionally, and where feasible with US counterparts. A “training of trainers” approach should be taken to develop local capacity to deliver training courses to associations after US support is withdrawn.

At **Stage Three** funding should go towards offsetting costs for regional networking among associations, promoting partnerships with US business groups, and financing best practices workshops for association representatives. While these activities are more global than local, USAID sponsored programs should also encourage business groups to support local area development. These activities should strengthen public

perception of smaller businesses and their associations as important supporters of their community.

### *Technical Assistance to Enterprises*

At **Stage One** most assistance to enterprises is provided by foreign expertise, either directly or in cooperation with business service organizations (which are also subsidized with donor funding). Even at this stage, programs must include training of local professionals and partnering them with foreign experts. Some attention should be placed on educating entrepreneurs on how to use consulting services more effectively.

At **Stage Two** subsidies to BSOs will be reduced, but assistance will be provided to help them identify other sources of funding – both through revenue generating activities as well as other grant funds (see lessons learned). Programs will make greater use of local experts to manage and deliver technical assistance and training to enterprises. Foreign experts will be used to train local service providers – consulting firms, independent professionals, university business professors, and associations. USAID and local government funds may be used to establish and subsidize business counseling programs which service potential and existing firms during the pre-start up and start up phases. These counseling programs help owners to identify problems and develop solutions, rather than finding solutions for them, which is more the role of consulting.

**Stage Three** will see a greatly reduced level of funding for technical assistance and training for enterprises, with the possible exception of microenterprise support. Some small amounts of funding may be targeted to events or activities that promote best practices in specific industry groups, strengthening of information networks, cross-border linkages among trade associations, promotion of standards in the consulting industry, and the like. Business counseling services should be evaluated and improved at stage three and governments, at all levels, should be encouraged to look at these counseling and training activities as an integral part of the public education process.

### *Financial Services*

**Stage One** programs will focus on getting financing into the hands of at least several qualified enterprises. At this stage, since banks are not interested or able to meet the long-term capital requirements of private enterprises, little can be done to benefit the whole sector. However, lines of credit targeting small and microenterprises should be established, and the results of their activities (i.e., the benefits to businesses, the techniques of due diligence, loan appraisal, and workouts) should be publicized widely as a means of demonstrating good lending practices. Programmers should take care not to place undue emphasis on loan making if macroeconomic indicators show that the government is running a deficit which essentially absorbs all private savings.

Some non-bank financing schemes may also be introduced at this early stage. Credit unions are a good tool for entering into both rural and urban markets. Microfinance schemes in collaboration with local NGOs can also be effective in reaching the smallest of businesses. Specialized short term credit associations to support agricultural activities might also be introduced at this stage. The lack of a legal framework for these and other types of non-bank financial services also must be addressed as part of the legal reform agenda.

Most important is to push the macroeconomic reforms necessary to free up capital for lending to productive enterprises. (Macroeconomic issues are being addressed largely by the IMF and the World Bank, so they may be less of a priority for USAID funding.) An agenda for reforming numerous other laws and regulations must also be pushed at the central government level – tax law, property law, contract law, collateral to mention a few. Financial service development is intimately linked to USAID's legal and regulatory reform programs.

At **Stage Two** macro economic conditions should be improving to the point that both the government deficit and the inflation rate fall to manageable levels. There should be at least a few progressive commercial banks that are lending to the sector. Training and technical assistance should be provided, to improve bankers' capabilities to provide small loans and to provide due diligence reviews of loan requests. At the same time, small business owners must learn how to approach the lending institutions with well-documented loan requests. In addition to making loans at this stage, USAID programming should improve bank supervision and regulation. Self-regulating entities (e.g. associations of bankers) should also be encouraged. Creation of a viable securities exchange commission and stock market are priorities in countries large enough to support these activities. USAID should encourage adoption of the full disclosure standards for joint stock issuance as practiced in the US. Public education in the operations of secondary markets is also important.

Other non-banking schemes should be introduced at this stage such as equity financing and leasing. Governments should also support creation of institutions to provide industrial, commercial and agricultural mortgages. Government activities should include continued improvement of property law, development of a land cadastre, and collateral registries to support the mortgage lending process. The results of these efforts, too, must be widely disseminated not only to encourage businesses, but also to promote the idea of competition in the financial services market, and attract the interest of commercial banks to begin lending to enterprises. USAID's loan portfolio guarantee program – the Development Credit Authority – can also be useful to help share risk that banks incur in lending to the small business sector.

Support for microfinance will still be needed at this stage in order to meet the needs of the smallest businesses. Given that commercial banks at this stage are only beginning to lend to a substantial degree to medium and small businesses, it is highly unlikely that they will opt to go further downstream into the micro market. Reform of legislation allowing NGOs to expand their financial product lines and leverage their

capital base may be necessary if such programs are to reach appreciable numbers of microenterprises.

At **Stage Three**, a range of financial services for most business sectors and sizes exists. There are likely to be some outstanding legal/regulatory issues that need to be addressed, but USAID's role here will be to promote dialog and local research into these issues as described above. Some continuing training in best practices in both banking and non-banking services may be warranted, and may be administered by local expertise. USAID should support programming to help domestic firms access international financial markets.

### *Educating the New Generation of Entrepreneurs and Managers*

**Stage One** resources should be utilized to train educators in the principals of market economics and modern business management. Where funds are available, MBA degree programs should be supported, and affiliations with American universities established. Programs should be aimed at introducing youth to the workings of a market economy, the role of business, and the importance of good business practices to the community and the nation.

It is also important to begin public education programs, through independent media where it exists. Promoting not only the principals of market economics, but also a healthy image of small, local businesses to the public at large will be needed at stage two as well. These public campaigns should be closely coordinated with work in legal reform and association development, because both programs have the creation of an enabling environment as a top priority. Public support for these initiatives will strengthen the positive impression government has of business.

At **Stage Two** USAID implementers should identify opportunities in their enterprise technical assistance, association development, and legal reform programs to give youth "hands on experience" with matters related to managing a competitive enterprise and fostering a competitive marketplace. Integrating opportunities for young entrepreneurs into ongoing programs should not be treated as a fringe activity, but rather as a mainstream effort to nurture the ideas and goals of the next generation of managers and decision-makers. Although this is an important function of universities and secondary education institutions, they are likely working under a severe budget constraint, thereby making the need to provide positive learning experiences to youth that much more urgent. Where available, local private training institutions should be utilized – this further encourages the development of an effective market for training services.

Public education programs must be continued, with an increasing focus on showcasing "good" local businesses. Implementers should also help associations to utilize media groups to promote their industry.

**Stage Three** will focus on facilitating partnerships between businesses, associations and education institutions to promote continuing education for managers, and

workplace training opportunities for young entrepreneurs. By the end of stage three, secondary and higher education curriculums should have fully integrated information about the functioning of the market system.

### *Privatization*

The **Stage One** priority for privatization is to help government establish the procedures and policies for wholesale movement of state-owned assets efficiently into private ownership (with good corporate governance). A precondition to this is the development of a property law that defines the rights of owners to use and sell their assets. The two mechanisms for this are small-scale privatization, in which smaller enterprises are sold through auction or management buy-out, and mass-privatization, in which citizens can acquire shares of companies in exchange for coupons. Foreign advisors can facilitate this process through policy advice, management consulting services, and public information programs.

Experience has shown that such programs are extremely effective in transfer of ownership, although in mass privatization managerial accountability has been a problem. Mass privatization programs now encourage the presence of a “control owner” to counter the problem of diffuse ownership. While providing these services, USAID programming should emphasize the transfer of skills and knowledge to local counterparts who can continue the work. The privatization process can take several years, depending on how determined the government is to complete the reforms. Land privatization should be an integral part of Stage One – specifically agricultural land – to provide clear ownership interest as well as source of collateral for borrowing.

At **Stage Two** programs will start to focus on privatization of medium and larger enterprises through tender privatization, a closed bid process in which the government stipulates the terms and conditions which bids must respond to – i.e., investment, employment, price. Experience has shown that tender privatization is dependent upon political will, and such assistance should only be given when the government has made a clear and verifiable commitment to transfer assets to the private sector. In these cases, the stakes are higher as the existing power structure is more entrenched and the employment impacts are significant. Privatization of the land under enterprises is important at this stage as well.

At this stage, USAID should encourage managerial accountability and the promotion of good corporate governance as well as transparent financial reporting.

**Stage Three** will see highly focused involvement with privatization, targeted towards those “strategic” companies where limited resources can leverage significant results. In regard to strategic companies, USAID’s role is best limited to preparing the regulatory and competition environment for privatization, as a preparatory step for the engaging of investment banks which are best suited to manage privatization.



### 4.3 Program Management Strategies and Priorities

Successful use of the strategy requires that USAID and its partners select program elements based on a broader view of factors (both within the business and external to the business) that will create more profitable enterprises. Once this overview (tailored to a country's conditions) of factors has been specified, regular monitoring and review of changes in the market should become part of an ongoing dialog among program managers and counterparts. In this way, there is greater likelihood of programs evolving in relationship to new constraints or opportunities. USAID will take an active strategic management role in its programs by facilitating dialog among implementers and other partners.

#### *Adapting Programs to Country Conditions*

To properly select and adapt program strategies to local conditions, USAID Missions will conduct a diagnostic survey of key issues, enterprise sectors, stakeholders, policy impediments, and strengths/weaknesses of partner institutions. The survey will also examine the contributions of women entrepreneurs and constraints to the growth of their businesses. (See diagnostic questionnaire presented in Annex A and the classification system for transition indicators in Annex C.) Where there is no baseline on private sector (formal and informal) activities, USAID should fund such a survey to help inform its own programs, as well as decision makers in government, about the nature of the private economy, and the problems that need most work. There are several examples of surveys done in the region that can be used as a model.

The results of the diagnostic review of local conditions will be used to discuss priorities and strategy options with implementing partners and host country counterparts. Existing programs will be modified where necessary and feasible (depending on the nature of the existing grant agreement or contract). A mix of programs relating to the stages of enterprise development will be selected, and an implementation timeframe determined. Depending on resources available and which are the most critical needs, missions may not be able to, or not need to, have programs in all six areas. Throughout implementation, USAID and its partners should monitor programs to assess the extent to which necessary processes and institutions have been developed to advance to the next stage of enterprise development.

***As programs are being implemented, USAID and its partners should monitor them to assess the extent to which necessary processes and institutions have been developed to advance to the next stage of enterprise development.***

The country assessments should also be used to identify new institutions or experts that have the potential of working with USAID and its implementers in a partnership that promotes enterprise development objectives.

### *Managing Programs to Maximize Synergy Among Implementers and Local Partners*

To leverage the greatest impact, USAID and its implementing partners should seek to integrate activities, not only within the private enterprise portfolio, but also across Strategic Objectives that impact on the competitiveness of markets. For example, USAID's democracy and governance programs generally include activities to strengthen municipal governments and their interface with civic groups and businesses in the community. This creates the opportunity to combine resources and strategies that will enhance the potential for local economic development based on a healthy, growing business community. Creating this synergy is another strategic management role for USAID Missions.

### *Supporting Regional Networks that Promote Sustainable Private Enterprise Development*

USAID partners – business, governmental entities, and non-profit organizations – in the region are unanimous in their desire for greater cross-border sharing of information to help promote trade, investment, legal reform efforts, and a whole range of lessons learned about enterprise development approaches and strategies. Each country recognizes that its success is intimately linked to commercial and political relations with its neighbors. USAID should build on this interest by supporting regional information networks, stakeholder meetings, exchanges and conferences that bring together peers throughout the region. These can be a useful contribution made by the “legacy mechanisms” being created in the region. (See Executive Summary.)

Internet technology is a promising tool to facilitate regional networking. It would be relatively easy for USAID/Washington and Missions to create a regional virtual forum for debating key issues, exchanging information and lessons learned. Most major local organizations – public and private – in the region have ready access to internet services. There are also already a number of locally managed web sites that can facilitate linkages to stakeholders and promote further dialog on enterprise development issues of regional interest. The key to success with this technology, however, will be dedicating some level of technical expertise to facilitate exchange of ideas, raise issues for discussion, and refer any queries to the best sources of information.

## 5. Background Information on Private Enterprises in the Region, and Considerations that Frame USAID's Approach to the Strategy

Beginning in September 1998, USAID initiated a series of activities intended to create a dialog among USAID staff, program implementers, and host-country partners about a vision for private enterprise in the 21<sup>st</sup> century, and a strategy for realizing it. These events included meetings in Washington, various conferences in the field, and the establishment of a listserve to share ideas, debate issues, and discuss background documents for the strategy. The key field activity was a February 1999 conference in Sofia that was attended by more than 120 representatives from 20 countries. Participants included parliamentarians, association leaders, entrepreneurs, policy experts, program implementers, and USAID staff.

The recommendations coming out of this forum are summarized below. Many of them will be incorporated into USAID's strategy for enterprise development in the region. The recommendations were to:

- Introduce and help foster non-bank lending and financial services.
- Increase program focus on the informal sector.
- Recognize that women entrepreneurs are at a disadvantage in the region, and that their growth must be encouraged through integration into existing enterprise development programs, and specific outreach to them when necessary.
- Strengthen regional commercial and institutional, private and public sector linkages.
- Encourage the US private sector to become more involved in the region by expanding linkages (e.g. trade and investment opportunities) to regional SMEs.
- Facilitate greater information exchanges at all levels.
- Promote the sustainability of business support services, using a combination of fees and subsidies.
- Encourage greater regional commercial and institutional exchanges.
- Expand East-East and East-West cooperative initiatives that promote institutional development, trade, and investment.

Also in February, a background paper was circulated to about 250 USAID staff, implementers and host-country counterparts. The paper discussed key issues and lessons learned, and made some initial suggestions about a policy framework and program priorities to guide USAID's work in private enterprise development into the

next century.<sup>12</sup> The background paper was used as the basis for discussion among USAID staff and partners in a virtual meeting that took place in March/April.<sup>13</sup>

## 5.1 Context for Private Enterprise Development in the Region

As mentioned earlier, the transition towards a market economy in many countries has proceeded at a pace slower than was expected in the immediate aftermath of the communist governments' downfall. Some countries have fared well according to certain economic and political indicators, while others have lagged or even slipped backward in their progress towards an open market system. (See Section 2, Figure 1: Economic Policy Reforms, Democratic Freedoms and Enterprise Development in ENI.)

These differences are also reflected in the status of private enterprises. The share of GDP, for example, attributable to private sector activities in ENI countries ranges from a low of 20 percent in Belarus to a high of 75 percent in Albania, Czech Republic, Hungary, and Slovak Republic. (See Annex B, Table 1, "Private Sector Share of GDP Among ENI Countries.") Although overall growth in total GDP throughout the region has improved annually since 1992, country differences are marked. Ukraine, for example, were expected to have growth of only 1 percent in 1998, while Turkmenistan, Georgia, and Albania were expected to have growth of 10 percent or greater. (See Annex B, Table 2, "Growth in Real GDP in ENI

Private investment and GDP growth are two important measures of progress towards market reform. Others are useful as well. Each year the European Bank for Reconstruction and Development (EBRD) prepares a transition report that attempts to measure how well ENI countries are moving forward in instituting a market-based economy. A feature of this report is a scoring system of progress in critical transition indicators (privatization, market reforms, trade liberalization, etc.) Looking at these indicators, we see overall improvements in the region, but significant disparity among individual countries. On a scale of 1 (little progress) to 4 + (essentially full achievement of transition indicator), whereas the ENI region averaged 0.2 across all indicators in 1994, this improved markedly to just over 2.7 in 1997. (See Annex B, Table 3, "Progress in Transition in ENI Countries, 1997.")

According to the EBRD report, the transition is complete when the elements outlined in Table 2 below have been achieved.

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<sup>12</sup> "Private Enterprise Growth in Eastern Europe and The Former Soviet Union in the 21<sup>st</sup> Century: Creating a Vision for the Future," Russell Webster, Management Systems International, February 1999. (Background discussion paper prepared for US Agency for International Development)

<sup>13</sup> A copy of the background paper and of comments made during the virtual meeting can be obtained from <http://barracuda.msi-inc.com>.

**Table 2: EBRD Transition Elements and Objectives**

<i>Transition Element</i>	<i>End-Objective</i>
Large Scale Privatization	More than 75 percent of enterprise assets in private ownership with effective corporate governance.
Small Scale Privatization	No state ownership of small enterprises; effective tradability of land.
Governance and Restructuring	Effective corporate control exercised through domestic financial institutions and markets, fostering market-driven restructuring.
Price Liberalization	Comprehensive price liberalization; efficiency-enhancing regulation of utility pricing.
Trade and Foreign Exchange System	Removal of most tariff barriers; membership in WTO.
Competition Policy	Effective enforcement of competition policy; unrestricted entry to most markets.
Banking Reform and Interest Rate Liberalization	Full convergence of banking laws and regulations with BIS standards; provision of full set of competitive banking services.
Securities Markets and Non-bank Financial Institutions	Full convergence of securities laws and regulations with IOSCO standards; fully developed non-bank intermediation.

## 5.2 Transition Assumptions Revisited

Enterprise development is an integral part of US foreign policy objectives in the region of promoting market based economic growth and democracy. The program approaches, however, have changed over time as USAID and its partners have learned more about the conditions affecting private sector development. In a recent review of the “transition assumptions” underlying USAID’s approach to development in the region, USAID determined that the original set of assumptions were in many cases incorrect, and needed to be revamped to achieve greater impact.<sup>14</sup> This is critical as the Agency looks towards its declining role in the region into the 21<sup>st</sup> century.

Immediately following the fall of communism, USAID and most donors assumed that a significant injection of capital and technical know-how would be sufficient to “kick start” the fledgling market economies of ENI. It was of course recognized that countries began at different stages on the path leading them away from a centrally planned economy. A country’s unique history, culture, political economy, and location in relation to other markets created a set of constraints and opportunities for future growth. The Czech Republic had minor ground to cover – having been the world’s eighth most industrialized country before World War II – compared to countries like Albania or some of the Central Asian Republics, which had been more isolated from markets, and had a much smaller industrial base to build upon. Still, the approach to

<sup>14</sup> “ENI Stocktaking: Review of Program Assumptions,” 2/18/99.

development was similar: get capital into the hands of promising entrepreneurs, teach business management skills, advise decision makers on economic reform, show banks how to operate in a viable commercial basis. The rest would follow.

As it turns out, this approach tended to underestimate the fundamental complexity of the situation – both political and economic – in the post-communist world. At many levels, institutional and inter-personal relationships – for example between central ministries and local governments – worked against much needed reforms, slowing down the emergence of a market-led economy. At best, frequent and sometimes haphazard changes in the law had the effect of confusing the business community. At worst, the changes were outright attacks on the principals of competition and private ownership of the means of production.

Politicians, reluctant to make decisions that dismantle the traditional power base and require a package of strong reform measures to avoid unemployment and social dislocation, stall reform on major areas such as privatization, banking reform, land reform, and laws on competition. Businesses, frustrated by government bureaucracy, corruption, and the Mafia, went into the shadow economy to avoid detection. Without a growing formal economy, government accounts were unable to meet the demands for infrastructure development, public works, social services and education.

The revised assumptions place greater emphasis on reforming institutions and systems that determine how the economy and the society are structured and operate. For example: building political will for reforms, promoting transparency in decision making processes, shifting from a command and control role for government to a regulatory and monitoring role, fighting corruption, etc.

This does not rule out the validity of work that has been done over the past decade. Technology transfer and skill building are still needed. However, it does suggest that USAID and its partners should adopt a strategy that helps to bolster institutions that will sustain the transition initiative as USAID moves towards phasing out of the region. With this new thinking in mind, USAID policy for private enterprise development now focuses on the creation of partnerships that will sustain the transition to its ultimate aim, establishment of an open-market economy where:

- Businesses of all sizes can compete fairly.
- Relationships with the US are not based on donor assistance, but on markets.
- And, trade, commerce and investment are priorities for the state and the society.

The conclusions of the discussion on transition support USAID's aim of creating new partnerships among public and private sector stakeholders in the region, and among USAID, its implementing partners, and counterpart institutions working for private sector development. (See discussion of partnerships and institutions above in Section 1.4) These partnerships must be able to sustain the benefits gained once USAID phases out of the region over the next few years.

The issues discussed in the ENI Bureau's stocktaking exercise of transition assumptions in the region are important to the design and implementation of the strategy presented here. Table 3 summarizes the issues that are most relevant to private enterprise development.

**Table 3: USAID Review of Program Assumptions for Europe and the New Independent States**

<i><b>Old Assumption</b></i>	<i><b>New Assumption</b></i>
A "Marshall Plan" type model can be applied to countries in transition: capital injections and technology transfer will "kick start" the process.	Transition of countries in the region requires more fundamental changes in policies, institutions and behavior.
Countries in the region share a common path in creating a market economy: stabilization, liberalization and privatization would transform the centralized economic systems into competitive market economies. The growing middle class will continue advocating for democratic governance, and prevent slipping back to the communist/socialist model of government.	These are not emerging economies, rather emerging societies. Progress is heavily influenced by popular sentiment about social and political issues, sentiments that are changing in reaction to disruptions in the social and economic order. Transition involves the fundamental processes of nation-building and forming a national identity. One size does not fit all. Programs and expectations must be adjusted according to country-specific circumstances.
Governing elites in the CEE and NIS share a common vision on transition. The "ideas" of reform were powerful enough to engender support among decision makers at all levels.	There is no consensus in most NIS countries and in some of the southern tier CEE nations about what kind of society they want to ultimately be, resulting in fundamental disagreements about the institutional arrangements needed for transition.
Achieving the transition will not require a protracted program of assistance. Strategic targeting of resources will support the critical period of economic and political transition, which can be followed by a quick phase-out.	Expectations must be adjusted to a more realistic timeframe. Extending the timeframe for assistance makes it possible to address long-term constraints to transition.
Post-communist countries are not underdeveloped, rather "mis-developed" and out of sync with international market forces. Effective institutions are in place, although there is a need to create additional institutions fundamental to a market democracy.	Formal and informal public and private sector institutions fundamental to the operations of a market economy and democracy are lacking or severely underdeveloped in many CEE and NIS countries.

<b><i>Old Assumption</i></b>	<b><i>New Assumption</i></b>
High literacy rates, technical and scientific capacity makes available a productive labor force ready to respond to opportunities created by a market economy. The nascent entrepreneurial spirit will assert itself naturally once the bonds of authoritarianism have been stripped away.	Changing behavior is a long-term process. Also, post-communist deterioration of education and health care systems undermined anticipated comparative advantages of human capital and labor force. Long-term investments in education and health are needed. More resources need to be devoted to educating the younger generation about principles of market democracies, including the respective roles of individuals and governments.
With the introduction of market-oriented economic instruments, values and techniques, corruption is likely to decline.	Economic restructuring will not be successful without addressing corruption.
Because gender “parity” was implied under the old system, USAID need not take gender into account in designing and implementing its assistance programs.	The post-communist transition is exacerbating gender-based disadvantages facing women. Women are neither fully participating in, nor fully benefiting from the respective countries’ economic and political life.

These revisions apply also to lessons learned in private enterprise development. The initial focus was on pushing the transition with technology transfer (firm-level technical assistance, creation of business development centers), capital injections (American Enterprise Funds and, in some countries, affiliated micro-credit programs), privatization, and advising governments on policy reform. However, USAID and its partners now realize that there needs to be a fundamental shift in the structures that promote good business practices and enable the market to operate.

Although many of the early approaches used are still relevant, additional focus is needed on strengthening indigenous business services delivery capability, reforming institutions, building new relationships among stakeholders (public-private sector dialogue and partnership), creating political will, and educating future generations.

The rationale behind USAID’s approach is that the objective is not simply to improve business operations, but to rather replace what was formerly a closed, centrally planned system of economy with an open, competitive system. This requires not only technology transfer, but also a shift in social attitudes and political will about what kind of nation the transitioning countries wish to become. (See the discussion above under assumptions revisited.)

How should USAID and its partners adapt programs to address conditions in each stage of development? Earlier sections of the report have offered some detailed descriptions of program strategies and management approaches. Just as the stocktaking review of program assumptions has identified capacity building as an important key to success, the trend moving up the stages of enterprise development is one of substituting direct foreign assistance to enterprises, banks, government agencies and other groups with an approach that facilitates:

- Institutional capacity building,



- Partnerships among key stakeholders and institutions that will continue pressuring the government to institute market reforms,
- Sustainability of enterprises and the services (technical, managerial, and financial) that support them in the local marketplace, and
- Broad acceptance and support of the principles of market economics.

In this way, the elements will be put into place to sustain the transition process to its completion so that enterprises will be able to compete in local and foreign markets.

## **Annex A: Stages of Enterprise Development – a Diagnostic Series of Questions**

### **Legal and Regulatory Reforms**

What is the state of the legislative framework for business in this country? Are there good contract laws? private property law? intellectual property law? Securities law? Bankruptcy law? Collateral Law?

Is there a Civil Code or a Commercial code? When was this law written (or significantly updated)?

Is there a stock market? What stock exchange model is the market based on?

How long has the stock market been in operation? Is there more than one stock market in the country? How many?

Who proposes new law? Are there parliamentary committees to review laws affecting business?

Are proposed laws published prior to consideration by the parliament? How far ahead are they published? Is public comment (by individuals, by associations) invited? How long is the comment period? How long does it take to pass a typical law?

Do government ministries publish regulations defining how laws are to be enforced? Are these regulations subject to notice and comment rule making? Who writes regulations? Who enforces them? What penalties are associated with a sample of regulations?

Do trade associations or chambers of commerce comment on draft laws?

Are there any thinktanks attempting to monitor government rule-making as it effects private business?

Has the amount of new legislation passed changed in the last three years?

### **Association Development**

Is there a national chamber of commerce and/or industry?

If yes, is membership mandatory or voluntary? How many businesses are members?

How are dues payments determined?

What are the principle functions of the national chamber?

Are there any sub-chambers (by industry, trade, or geography) associated with the national chamber?

Are there any regional chambers (where regional could be a metropolitan area or a larger sub-national area)? Are they affiliated with a national chamber?

How many independent trade or industry associations are there in the country?

How old are these organizations? How large is their male and female membership? Is membership growing or declining over time? How large are their budgets?

What degree of influence does each of the major organizations have with the Parliament?

Does any organization perform quasi-legal functions for the state (Local chambers often supply Certificates of Origin, for example)?

Does any organization have an existing partnership with a U. S. organization or any other foreign organization?

### **TA/Training for Enterprises**

Is there any indigenous training activity for business owners/managers at the central government level?

Are there any private or NGO-sponsored TA and Training Activities ongoing?

Are there any training programs sponsored by multi-lateral or bilateral programs? What are the percentages of men and women trained in these activities?

Do any of the programs noted above charge a full cost fee for the training? Do any of them provide services for partial fees (for example, charging fees for variable costs only)? If there is a subsidy to a particular program, who pays the subsidy?

Are there any business counseling activities ongoing? Counseling activities differ from consulting activities in that consultants work to directly solve a client's problem, while counselors help a client identify a problem, choose a viable solution, and actualize the solution. Counseling is usually accompanied by skill training as part of the solution process. Simply put, Consultants "do for" their clients; Counselors assist

Are there any business management training courses available on a non-degree basis from local universities?

Do local universities have a faculty of business (perhaps as part of the economics faculty)? Do any local schools provide an MBA degree? Does the program offered meet Western standards?

Do local universities and the national or local governments cosponsor any cooperative training or technical assistance programs?

Are there any foreign consulting firms with offices in the country? Are these firms expanding their business base over time? Are they expanding their program within the country?

### **Financial Services**

This section probably needs some macro questions prior to getting down to banking or other financial issues.

Did the state run a deficit on the current account last year? How large was it as a percent of the Government budget? As a percent of GDP? How was this deficit financed (internally by printing money, absorbing some or all private saving, or externally by borrowing)?

What was the inflation rate for each month or quarter over the last two years?

Is there an independent Central Bank? What are the functions of the Bank? Does it make any loans to entities other than banks?

Are the banks in the country state-run? Private? Private and Public co-owned?

How many banks are there in the country?

Are there any banks owned by foreign interests? Are these full service banks?

Are there any financial service firms other than banks in the country (examples would include leasing firms, other asset-based lenders, credit unions, savings banks, etc.)

Do banks make business loans in dollar terms or in local currency terms?

Is there a functioning bankruptcy law? Is there a collateral register? Is this a national register?

Can a bank reasonably enforce a bankruptcy judgment? Can the bank initiate the bankruptcy with the court system? How long does it take to process a bankruptcy?

How do banks define delinquencies? And foreclosures? Are they held to these definitions by the government? Can they make a new or rollover loan to cover delinquent payments? Does the local bank accounting standard meet the standard for US or EEC bank?

Are there any private or bank-run training institutes for bank loan officers?

What is considered to be a short-term loan? Medium-term? Long-term?

How much collateral needs to be pledged for a business loan?

### **Educating the New Generation of Entrepreneurs and Managers**

Are there curriculums available for all grade levels, describing the nature of a market economy? Are there teaching aides or curriculum materials available to teachers?

Are there any programs to train teachers in market economics?

Are there any public, private, or cooperative programs to train government officials in public administration?

Are there any youth programs such as Junior Achievement?

Is there any extension training available to business owners/managers from local colleges or universities?

Are there any colleges or universities partnering with Western institutions to introduce management or skill training for entrepreneurs?

Is there any vocational training for young people wishing to study entrepreneurship?

Are there any private business schools which focus on business skill training or on management training? How many people are being trained in these institutions?

What has been the percentage of male and female participation in these activities?

### **Privatization**

What proportion of small, medium and large government organizations have been privatized in the past year? Two years? Three years?

What proportion of total employment is in state-owned enterprises?

What is the unemployment rate in the country? How has this changed in the last two years?

What has the government announced about privatization plans in this year? Next year?

Have foreign entities brought significant amounts of privatized assets? Are they allowed to bid for such assets?

What has been the trend in the cost of government subsidy to the enterprise sector?

What percent of the loans in the banking sector are to the State-Owned Enterprises?

What percent of tax arrears and arrears in payment of social charges (pension and health contribution) are attributable to the State-Owned Enterprise sector?

## **ANNEX B: Tables and Figures for EBRD Transition Indicators**

**TABLE 1: PRIVATE SECTOR SHARE OF GDP  
AMONG ENI COUNTRIES**

Countries	Population (millions, mid-1995) <sup>15</sup>	Private Sector Share of GDP in %, mid-1997 (rough EBRD estimate) <sup>16</sup>
Albania	3.2	75
Armenia	3.7	55
Azerbaijan	7.5	40
Belarus	10.4	20
Bulgaria	8.4	50
Croatia	4.8	55
Czech Republic	10.3	75
Estonia	1.5	70
FYR Macedonia	2.1	50
Georgia	5.4	55
Hungary	10.3	75
Kazakhstan	16.8	55
Kyrgyzstan	4.5	60
Latvia	2.5	60
Lithuania	3.7	70
Moldova	4.4	45
Poland	38.5	65
Romania	22.7	60
Russian Federation	148.4	70
Slovak Republic	5.3	75
Slovenia	2	50
Tajikistan	5.8	20
Turkmenistan	4.4	25
Ukraine	51.9	50
Uzbekistan	22.4	45

<sup>15</sup> This list includes all of the EBRD's countries of operations with the exception of Bosnia and Herzegovina, which has not been assigned scores due to the fact that the economy is still divided into separate enclaves not conducive to a single overall assessment.

<sup>16</sup> The "private sector shares" of GDP represent rough EBRD estimates, based on available statistics from both official (government) sources and unofficial sources. The underlying concept of private sector value added includes income generated by the activity of private registered companies as well as private entities engaged in informal activity in those cases where reliable information on informal activity is available. Here the term "private companies" refers to all enterprises in which a majority of the shares are owned by private individuals or entities. The roughness of the EBRD estimates reflects data limitations, particularly with respect to the scale of informal activity. The EBRD estimates may in some cases differ markedly from available data from official sources on the contribution to GDP made by the "private sector" or by the "non-state sector". This is in most cases because the definition of the EBRD concept differs from that of the official estimates. Specifically for the CIS countries, official data in most cases refer to value added in the "non-state sector" – a broad concept that incorporates collective farms as well as companies in which only a minority stake has been privatized.

**TABLE 2: GROWTH IN REAL GDP  
IN ENI COUNTRIES**

	1992	1993	1994	1995	1996	1997 Esti- mate	1998 Projec- tion	Estimated Level of Real GDP in 1997	Projected Level of Real GDP in 1998
	(percentage change)							(1989=100)	(1989=100)
Albania	-7.2	9.6	9.4	8.9	9.1	-8.0	12.0	<b>79</b>	<b>89</b>
Bulgaria	-7.3	-1.5	1.8	2.1	-10.9	-7.4	2.5	<b>63</b>	<b>64</b>
Croatia	-11.7	-0.9	0.6	1.6	4.3	5.5	5.5	<b>73</b>	<b>77</b>
Czech Republic	-3.3	0.6	3.2	6.4	3.9	1.0	2.0	<b>98</b>	<b>100</b>
Estonia	-14.2	-8.5	-1.8	4.3	4.0	10.0	5.5	<b>78</b>	<b>82</b>
FYR Macedonia	-21.1	-8.4	-4.0	-1.4	1.1	1.0	5.0	<b>55</b>	<b>58</b>
Hungary	-3.1	-0.6	2.9	1.5	1.3	4.3	4.5	<b>90</b>	<b>94</b>
Latvia	-34.9	-14.9	0.6	-0.8	2.8	6.0	6.0	<b>56</b>	<b>59</b>
Lithuania	-37.7	-17.1	-11.3	2.3	5.1	5.7	5.5	<b>43</b>	<b>45</b>
Poland	2.6	3.8	5.2	7.0	6.1	6.9	5.5	<b>112</b>	<b>118</b>
Romania	-8.7	1.5	3.9	7.1	4.1	-6.6	-2.0	<b>82</b>	<b>81</b>
Slovak Republic	-6.5	-3.7	4.9	6.8	6.9	6.5	3.5	<b>96</b>	<b>99</b>
Slovenia	-5.5	2.8	5.3	4.1	3.1	3.3	3.8	<b>98</b>	<b>102</b>
<i>Eastern Europe &amp; the Baltic States</i> <sup>17</sup>	-4.1	0.7	3.5	5.3	4.2	3.5	3.9	<b>95</b>	<b>99</b>
Armenia	-52.6	-14.8	5.4	6.9	5.8	3.3	6.0	<b>38</b>	<b>40</b>
Azerbaijan	-22.6	-23.1	-18.1	-11.0	1.3	5.0	7.0	<b>40</b>	<b>43</b>
Belarus	-9.6	-7.6	-12.6	-10.4	2.6	10.0	2.0	<b>71</b>	<b>72</b>
Georgia	-44.8	-25.4	-11.4	2.4	10.5	10.0	10.0	<b>32</b>	<b>35</b>
Kazakhstan	-2.9	-10.4	-17.8	-8.9	1.1	1.8	2.7	<b>58</b>	<b>60</b>
Kyrgyzstan	-19.0	-16.0	-20.0	-5.4	5.6	10.4	5.9	<b>59</b>	<b>62</b>
Moldova	-29.1	-1.2	-31.2	-3.0	-8.0	1.3	1.0	<b>35</b>	<b>35</b>
Russia	-14.5	-8.7	-12.6	-4.0	-4.9	0.4	1.5	<b>57</b>	<b>58</b>
Tajikistan	-29.0	-11.0	-18.9	-12.5	-4.4	2.2	4.4	<b>40</b>	<b>42</b>
Turkmenistan	-5.3	-10.0	-18.8	-8.2	-8.0	-25.0	12.0	<b>43</b>	<b>48</b>
Ukraine	-13.7	-14.2	-23.0	-12.2	-10.0	-3.2	1.0	<b>37</b>	<b>38</b>
Uzbekistan	-11.1	-2.3	-4.2	-0.9	1.6	2.4	2.0	<b>87</b>	<b>88</b>
<i>Commonwealth of Independent States</i> <sup>18</sup>	-14.3	-9.3	-13.5	-4.9	-4.6	0.5	1.7	<b>56</b>	<b>57</b>
<b>Eastern Europe, the Baltics and the CIS</b>	<b>-10.5</b>	<b>-5.5</b>	<b>-7.1</b>	<b>-1.1</b>	<b>-1.3</b>	<b>1.6</b>	<b>2.5</b>	<b>71</b>	<b>73</b>

Data for 1992-96 represent the most recent estimates of outturns as reflected in publications from the national authorities, the IMF, the World Bank, the OECD, PlanEcon and the Institute of International Finance. Data for 1997 are preliminary actuals, mostly official government estimates. Data for 1998 represent EBRD projections.

**TABLE 3: PROGRESS IN TRANSITION  
IN ENI COUNTRIES\***

17 Estimates for real GDP represent weighted averages for Albania, Bulgaria, Croatia, the Czech Republic, Estonia, FYR Macedonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia. The weights used were EBRD estimates of nominal dollar-GDP for 1997.

18 Here taken to include all countries of the former Soviet Union, except Estonia, Latvia and Lithuania. Estimates of real GDP represent weighted averages. The weights used were EBRD estimates of nominal dollar-GDP for 1997.



	Enterprises			Markets & Trade			Financial Institutions	
Countries**	Large-scale Privatization	Small-scale privatization	Governance & restructuring	Price liberalization	Trade & foreign exchange system	Competition policy	Banking Reform & interest rate liberalization	Securities Markets & non-bank financial institutions
Albania	2	4	2	3	4	2	2	2-
Armenia	3	3	2	3	4	2	2+	1
Azerbaijan	2	3	2	3	2+	1	2	1
Belarus	1	2	1	3	1	2	1	2
Bulgaria	3	3	2+	3	4	2	3-	2+
Croatia	3	4+	3-	3	4	2	3-	2+
Czech Republic	4	4+	3	3	4+	3	3	3
Estonia	4	4+	3	3	4	3-	3+	3
FYR Macedonia	3	4	2	3	4	1	3	1
Georgia	3+	4	2	3	4	2	2+	1
Hungary	4	4+	3	3+	4+	3	4	3+
Kazakhstan	3	3+	2	3	4	2	2+	2
Kyrgyzstan	3	4	2	3	4	2	3-	2
Latvia	3	4	3-	3	4	3-	3	2+
Lithuania	3	4	3-	3	4	2+	3	2+
Moldova	3	3	2	3	4	2	2	2
Poland	3+	4+	3	3	4+	3	3	3+
Romania	3-	3	2	3	4	2	3-	2
Russian Federation	3+	4	2	3	4	2+	2+	3
Slovak Republic	4	4+	3-	3	4	3	3-	2+
Slovenia	3+	4+	3-	3	4+	2	3	3
Tajikistan	2	2	1	3-	2	1	1	1
Turkmenistan	2	2	2-	2	1	1	1	1
Ukraine	2+	3+	2	3	3	2	2	2
Uzbekistan	3-	3	2	3-	2-	2	2-	2

\*The numerical indicators are intended to represent the cumulative progress in the movement from a centrally planned economy to a market economy in each dimension, rather than the rate of change in the course of the year. The classification system is described in detail below. This year the legal transition indicators are presented separately as are the indicators of environmental policy reform.

\*\*This list includes all of the EBRD's countries of operations with the exception of Bosnia and Herzegovina, which has not been assigned scores due to the fact that the economy is still divided into separate enclaves not conducive to a single overall assessment.

**TABLE 3 (continued): PROGRESS IN TRANSITION  
IN ENI COUNTRIES\***

**CLASSIFICATION SYSTEM FOR TRANSITION INDICATORS<sup>19</sup>**

Transition Element	Category	Description of The Category
Large-scale privatization	1	Little private ownership.
	2	Comprehensive scheme almost ready for implementation; some sales completed.
	3	More than 25% of large-scale enterprise assets in private hands or in the process of being privatized (with the process having reached a stage at which the state has effectively ceded its ownership rights), but possibly with major unresolved issues regarding corporate governance.
	4	More than 50% of state-owned enterprise and farm assets in private ownership and significant progress on corporate governance of these enterprises.
	4+	Standards and performance typical of advanced industrial economies; more than 75% of enterprise assets in private ownership with effective corporate governance.
Small-scale privatization	1	Little progress.
	2	Substantial share privatized.
	3	Nearly comprehensive programme implemented.
	4	Complete privatization of small companies with tradable ownership rights.
	4+	Standards and performance typical of advanced industrial economies; no state ownership of small enterprises; effective tradability of land.
Governance & restructuring	1	Soft budget constraints (lax credit and subsidy policies weakening financial discipline at the enterprise level); few other reforms to promote corporate governance.
	2	Moderately tight credit and subsidy policy but weak enforcement of bankruptcy legislation and little action taken to strengthen competition and corporate governance.
	3	Significant and sustained actions to harden budget constraints and to promote corporate governance effectively (e.g. through privatization combined with tight credit and subsidy policies and/or enforcement of bankruptcy legislation).
	4	Substantial improvement in corporate governance, for example, an account of an active corporate control market; significant new investment at the enterprise level.
	4+	Standards and performance typical of advanced industrial economies; effective corporate control exercised through domestic financial institutions and markets, fostering market-driven restructuring.
Price liberalization	1	Most prices formally controlled by the government.
	2	Price controls for several important product categories, state procurement at non-market prices remains substantial.
	3	Substantial progress on price liberalization; state procurement at non-market prices largely phased out.
	4	Comprehensive price liberalization; utility pricing which reflects economic costs.
	4+	Standards and performance typical of advanced industrial economies; comprehensive price liberalization; efficiency-enhancing regulation of utility pricing.

\*The numerical indicators are intended to represent the cumulative progress in the movement from a centrally planned economy to a market economy in each dimension, rather than the rate of change in the course of the year. The classification system is described in detail below. This year the legal transition indicators are presented separately as are the indicators of environmental policy reform.

<sup>19</sup> The classification system is simplified and builds on the judgment of the EBRD's Office of the Chief Economist. More detailed descriptions of country-specific progress in transition are provided in the transition indicators at the back of this Report. The classification system presented here builds on the 1994 Transition Report. To refine further the classification system, pluses and minuses have been added to the 1-4 scale this year to indicate countries on the borderline between two categories. The classification 4\* which was used in previous years has been replaced with 4+ though the meaning of the score remains the same.

**TABLE 3 (continued): PROGRESS IN TRANSITION  
IN ENI COUNTRIES\***

**CLASSIFICATION SYSTEM FOR TRANSITION INDICATORS**

Transition Element	Category	Description of the Category
Trade and foreign exchange system	1	Widespread import and/or export controls or very limited legitimate access to foreign exchange.
	2	Some liberalization of import and/or export controls; almost full current account convertibility in principle but with a foreign exchange regime that is not fully transparent (possibly with multiple exchange rates).
	3	Removal of almost all quantitative and administrative import and export restrictions; almost full current account convertibility.
	4	Removal of all quantitative and administrative import and export restrictions (apart from agriculture) and all significant export tariffs; insignificant direct involvement in exports and imports by ministries and state-owned trading companies; no major non-uniformity of customs duties for non-agricultural goods and services; full current account convertibility.
	4+	Standards and performance norms of advanced industrial economies; removal of most tariff barriers; membership in WTO.
Competition policy	1	No competition legislation and institutions.
	2	Competition policy legislation and institutions set up; some reduction of entry restrictions or enforcement action on dominant firms.
	3	Some enforcement actions to reduce abuse of market power and to promote a competitive environment, including break-ups of dominant conglomerates; substantial reduction of entry restrictions.
	4	Significant enforcement actions to reduce abuse of market power and to promote a competitive environment.
	4+	Standards and performance typical of advanced industrial economies; effective enforcement of competitive policy; unrestricted entry to most markets.
Banking reform and interest rate liberalization	1	Little progress beyond establishment of a two-tier system.
	2	Significant liberalization of interest rates and credit allocation; limited use of directed credit or interest rate ceilings.
	3	Substantial progress in establishment of bank solvency and of a framework for prudential supervision and regulation; full interest rate liberalization with little preferential access to cheap refinancing; significant lending to private enterprises and significant presence of private banks.
	4	Significant movement of banking laws and regulations towards BIS standards; well functioning banking competition and effective prudential supervision; significant term lending to private enterprises; substantial financial deepening.
	4+	Standards and performance norms of advanced industrial economies; full convergence of banking laws and regulations with BIS standards; provision of full set of competitive banking services.
Securities markets and non-bank financial institutions	1	Little progress.
	2	Formation of securities exchanges, market-makers and brokers; some trading in government paper and/or securities; rudimentary legal and regulatory framework for the issuance and trading of securities.
	3	Substantial issuance of securities by private enterprises; establishment of independent share registries, secure clearance and settlement procedures, and some protection of minority shareholders; emergency of non-bank financial institutions (e.g. investment funds, private insurance and pension funds, leasing companies) and associated deregulatory framework.
	4	Securities laws and regulations approaching IOSCO standards; substantial market liquidity and capitalization; well-functioning non-bank financial institutions and effective regulation.
	4+	Standards and performance norms of advanced industrial economies; full convergence of securities laws and regulation with IOSCO standards; fully developed non-bank intermediation.

\*The numerical indicators are intended to represent the cumulative progress in the movement from a centrally planned economy to a market economy in each dimension, rather than the rate of change in the course of the year. The classification system is described in detail below. This year the legal transition indicators are presented separately as are the indicators of environmental policy reform.

## Annex C: Classification of Transition Indicators for USAID Program Strategies

Note: The categories below are intended to be used in conjunction with the EBRD transition indicators when completing a country diagnostic. See the second table in this Annex which identifies the source of classification indicators to be used in completing the diagnostic.

**Table 4: Additional Classifications for USAID Strategy**

Transition Element	Category	Description of The Category
Business and Trade Association Development	1	No associations present.
	2	A few with limited member services and minimal technical capabilities to promote member interests.
	3	Several with expanding range of member services and technical capabilities to promote some of the member interests.
	4	Extensive network of highly professional associations with broad range of member services and strong technical capabilities to effectively represent most member interests.
	4+	Standards and performance typical of advanced industrial economies.
Technical Assistance and Training for Enterprises	1	There are no business support organizations.
	2	There are a few BSOs that have been fostered by donors but technical capabilities are minimal and performance is inconsistent and generally of low quality.
	3	There are an expanding variety of BSOs that are capable of providing a variety of the basic TA and training needs of the business community with some cost recovery.
	4	There is an extensive network of BSOs that can provide most of the TA and training needs of private businesses; cost recovery is the norm or financing is provided through a combination of fees and local support.
	4+	An extensive network of BSOs exists that can provide for all the TA and training needs of the market based private sector and has linkages with similar organizations in other western economies.
Government SME Support	1	SMEs are not supported by the Government.
	2	Government is becoming aware of the importance of SMEs and is attempting to find ways to deal effectively with them.
	3	Government creates an organization like the SBA or assigns responsibility for dealing with SME interests to a larger organization such as a department of industry; staffing and capabilities are minimal.
	4	Government has an effective organization or entity that can represent SME interests and provide many of the need of SMEs for information and support.
	4+	Governmental support for SME sector is well staffed to provide services and information typical of advanced industrial economies.
Financial Services for Micro, and SMEs.	1	Banking and non-banking financing and financial services are not available to micro, small and medium sized businesses.
	2	Bank financing and services available to a limited number of medium sized firms. Micro and small business needs not being met except through donor supported programs. Situation is similar for non-bank activities.
	3	Banks expanding activities with medium sized firms, may be introducing limited programs for small businesses based on experience with donor programs and the range of services is expanding. There is a broadening and deepening of the market as a greater variety of non-bank instruments are introduced. Micro-business needs typically met only via donor funded programs.

Transition Element	Category	Description of The Category
	4	Banks and non bank financial institutions are increasingly meeting the requirements of small and medium businesses with a wide variety of financing instruments and services. Limited financing for micro-enterprises via special programs.
	4+	Performance and standards typical of advanced industrial economies.
Educating the New Generation of Managers and Entrepreneurs	1	Minimal business and economic curriculum at the secondary, college and graduate levels.
	2	Business and economic curriculum are typically offered at the college and graduate levels but quality is mixed at best, due to lack of qualified staff and institutions.
	3	Business and economic curriculum of a minimally acceptable quality are more widely available at the college and graduate level, and business education may be getting added to the secondary school curriculum.
	4	Generally acceptable quality of business and economic education widely available.
	4+	Standards and performance typical of advanced industrial economies

**Table 5: Classification Sources for Completing the Diagnostic Analysis**

Transition Element	Classification System for Transition Element
<b>Legal and Regulatory Reforms</b>	
Governance & restructuring	EBRD (Table 3)
Price liberalization	EBRD (Table 3)
Trade and foreign exchange system	EBRD (Table 3)
Competition policy	EBRD (Table 3)
<b>Association Development</b>	
Business and Trade Association Development	USAID (Table 4)
<b>TA/Training for Enterprises</b>	
Business Support Organizations	USAID (Table 4)
Government SME Support	USAID (Table 4)
<b>Financial Services</b>	
Banking reform and interest rate liberalization	EBRD (Table 3)
Securities markets and non-bank financial institutions	EBRD (Table 3)
Bank and Financial Institutions - Credit and Services Available to SMEs and Micro-enterprises.	USAID (Table 4)
<b>Educating the New Generation of Managers and Entrepreneurs</b>	USAID (Table 4)
<b>Privatization</b>	
Large-scale privatization	EBRD (Table 3)
Small-scale privatization	EBRD (Table 3)

**Annex D: Private Enterprise And Structural Reform Sector Programs  
Involving Non-USAID Donor Activities**

**(Summary of Assistance In Eleven ENI Countries)**

**ROMANIA**

**1. Structural reform and private sector development**

- a) Structural adjustment
  - EU-Phare, assistance to accession
  - IFC/EDI/MIGA, TA - communications strategies programs
  - EU-Phare, BOP support
- b) Banking and Finance
  - EBRD, privatization of Romanian Development Bank
  - IFC/EDI/MIGA, on-going financing: for leasing companies and equity fund targeted at SMEs(IFC)
  - IFC, possible investment in privatizing a state bank; second leasing operation; insurance company
  - IFC, joint seminars, TA, banking system development
- c) State-Owned Enterprises
  - IFC, possible investments in privatized enterprises across broad spectrum
  - IFC, possible advisory work on privatization, securing strategic partners
- d) Private Sector Development
  - IFC, possible investment in private enterprise, including focused credit lines with SME target
  - IFC/CFS, advice on restructuring joint ventures, share offerings
  - IFC, competitive advantages of regions (EDI)
  - IFC, JVI private sector development (EDI)
  - EU-Phare, development and restructuring of SMEs
  - EIB, infrastructure development
- e) Agriculture and Rural Development
  - IFC, possible investments in agro-industries
  - EU-Phare, agricultural and rural development, restructuring and privatization of ROMCEREAL and land registration
  - EBRD, agribusiness development project
  - IFC, communications strategies program (EDI)
  - IFC, agricultural policy reforms (EDI)
  - Japan PHRD grants, preparation of agricultural reforms and sector investment operations
- d) Development Assistance Management – Strengthen impact of bank portfolio, increase effectiveness of new bank assistance and promote Romanian ownership of development agenda
  - IFC/MIGA/EDI, coordinated programs
  - NGOs, foundations, academia
  - multilateral and bilateral donors (unspecified)

**MOLDOVA**

**1. Private Sector Development**

- a) Promote production of competitive goods and services
  - IFC, support for wholesale food distribution network
  - and credit line through local bank
  - TACIS, and Dutch TA to ARIA agency
  - GTZ & TACIS, co-financing
- b) Ensure stable and efficient financial inter-mediation

- Dutch co-financing for PSD
  - IFC/MIGA. Financing for SMEs through investment fund, leasing company
  - EBRD credit lines
  - UK Know-how TA for local banks
  - IMF EFF, accounting reform and securities market
  - IMF, TA for NBM advisory services
- c) Develop private agriculture
- Multi-donor, TA and financial assistance for rural development
  - Swiss/SIDA, co-financing of Cadastre project
  - Multi-donor, TA and financial assistance for rural credit and micro-credit schemes
  - IFC/MIGA, INCON investment project, new financing for agro-processing
- d) Support private business and attracting investment
- TACIS, TA for improving bankruptcy law
  - IMF, TA for tax administration
  - EBRD, project and investment financing for road and air transport, district heating and water supply
  - IFC, TA for private business development
  - IFC/MIGA, FIAS review of framework for FDI
  - IFC/MIGA, possible project financing for mobile phone joint venture and fixed line services (Moldtelcom)

## **UZBEKISTAN**

### **1. Liberalization of Trade and Payments Regimes and Minimizing Distortions in the Financial Sector**

- a) Macroeconomic management – stabilizing and liberalizing the economy and strengthening market institutions
- GTZ & UNDP, technical assistance for macroeconomic management activities
  - UNDP, support for government's new Macroeconomic Policy Institute
  - EU, training for civil service
  - ADB & UNDP, technical assistance for aid coordination by Cabinet Ministers
  - World Bank, lending: institutional building TA,
  - World Bank, non-lending: high level seminars and structural policy issues, study visits, policy analysis (IDF), macroeconomic policy notes, economic updates, policy note on public investment, regional economic report, support for WTO accession
- b) Financial Sector and Pension Reform
- EU/TACIS, support to advisory services for commercial banking sector
  - World Bank, lending: financial sector institution building
  - IFC, credit line to support post-privatization and SMEs
  - World Bank, non-lending: EDI seminars on financial sector reform, EDI seminars and training, data and forecasting IDF, policy analysis IDF

### **2. Completing the liberalization of domestic trade and improving incentives for increased output and employment by the private sector in productive sectors**

- a) Improving climate for private foreign investment
- EU/TACIS, capacity building and support to Foreign Investment Agency
  - IFC, non-lending services: private investor conferences, review of the Mining Code, review of Bankruptcy Code, review of climate for FDI
- b) Enterprise privatization and restructuring
- EU/TACIS, capacity building and support to Foreign Investment Agency
  - EU/TACIS, pre-investment support to Private Investment Fund
  - EBRD, financing of Privatization Investment Fund

- EBRD and ADB, lines of credit to SMEs
  - World Bank, lending: enterprise institution building
  - IFC, lending: packaging industry, management consulting services for local entrepreneurs
  - World Bank, non-lending services: industrial structure policy note
- c) Agriculture Sector Development
- ADB, economic and sector work in agricultural sector
  - Germany, Switzerland, Israel, bilateral support for agriculture
  - World Bank, lending: cotton improvement. Agricultural enterprise restructuring
  - IFC, lending: tractor assembly plant, cotton processing project
  - World Bank, non-lending: agriculture sector notes
- d) Land Reform and Property Rights
- EU/TACIS, support for land registration

## **ARMENIA**

### **1. Sustained Growth Through Private Sector Development**

- a) Consolidate Macroeconomic Stability and Creditworthiness
- IMF, TA fiscal
  - UNCTAD, customs
  - EU-TACIS, Public administration
  - EDP
- b) Improve private Sector Environment
- IFC, possible projects in food processing and textiles
  - EBRD, wholesale market
  - TACIS/GTZ, management training
  - IFC, leasing
  - MIGA, operations mining and beverages
- c) Alleviate infrastructure bottlenecks (barriers to development of private sector exports and growth)
- EBRD Hrazdan, power maintenance, planned privatization framework
  - France/US Nuclear Safety
  - IFC, potential privatization of hydro
  - TRACECA, TA and funds for highways
  - EBRD, potential road project

## **BELARUS**

### **1. Macroeconomic Management**

- a) Stabilization of the Economy
- IMF, negotiations
  - UNDP, TA macroeconomic forecasting
  - World Bank, policy notes, TA: macroeconomic advisor to President
- b) Liberalization of Trade and Domestic Business
- IMF, negotiations
  - UNDP, support for WTO negotiations
  - World Bank, policy notes
- c) Developing an Efficient Financial System
- IMF, discussions
  - World Bank, policy notes
  - IFC, small-scale privatization program



- d) Developing Sound and Competitive Enterprise and Agricultural Sectors
  - SIDA, TA for land reform assistance
  - Germany, TA for pilot farm restructuring

## **BOSNIA and HERZEGOVINA**

### **1. Strengthening Macroeconomic Institutions and Policies**

- a) Improve Sustainability of Budgetary outcomes and policies
  - IMF, OHR, EU, UST
  - World Bank, new lending: public finance structural adjustment
  - World Bank, non-lending: public expenditure reviews, seminar on governance
  - World Bank, donor coordination: working on budget, donor conferences, development of co-financing strategy
- b) Efficiently Manage External Debt
  - IMF, UST, Paris and London Club creditors
  - World Bank, new lending: public finance structural adj. Credit
  - World Bank, non-lending: TA on debt management/state revenue source
  - World Bank, donor coordination: working groups on external debt law and on IBRD debt allocation
- c) Create a Fiscally Sustainable Approach to Social Assistance
  - EU, OHR, IMF, UST, NGOs
  - World Bank, new lending: public finance adj. Credit, and community development project
  - World Bank, supervision: employment generation projects
  - World Bank, non-lending: social sector note, public expenditure review, poverty assessment
  - World Bank, donor coordination: preparation for conference

### **2. Transition to a Market Economy**

- a) Promote efficient Growth Through Development of Private Sector
  - IFC and MIGA, UST, OHR, EC, EBRD
  - World Bank, new lending: privatization/banking adj. Credit, IPC woodworking sector
  - World Bank, supervision: IFC microcredit/venture capital; IGA and MIGA guarantee facilities
  - World Bank, non-lending: privatization private sector assessment; seminar on privatization (EDI)
  - World Bank, donor coordination: working groups, donor conference, co-financing strategy
- b) Promote Competitive, Effective Financial Sector
  - IFC, UST, OHR, EBRD
  - World Bank, new lending: privatization/banking adj. Credit, RS line of credit, IFC joint venture bank
  - World Bank, supervision: lines of credit, IFC microenterprise, local initiatives/micro-credit
  - World Bank, non-lending: TA banking
  - World Bank, donor coordination: economic policy task force, working group, donor conference, co-financing strategy
- c) Remove Constraints on Growth Caused by Inefficiencies in Labor Market
  - UST, OHR, EC, ILO
  - World Bank, new lending: public finance structural adj. Credit
  - World Bank, supervision: demobilization, public works, local initiatives
  - World Bank, donor coordination: economic policy task force, working groups, donor conferences, co-financing strategy

## **BULGARIA**

### **1. Macroeconomic Stability**

- a) Transition Completion and EU Accession
  - IMF, standby arrangement

- EFF, ongoing consulting and TA
- EU, macro-financing
- EU-Phare, financing for communications to promote economic reform
- Open Society Foundation, grant for debt management
- Japan PHRD, grant for debt arrangement
- US Treasury, grant financed support for debt management
- Joint EU Bank, consultative group meetings
- World Bank, technical and advisory services

## **2. Private Sector Development: Structural Reforms, and Market Liberalization**

- a) Privatization and Financial Discipline in the Enterprise Sector
  - Japan PHRD grant, preparation of fast-disbursing IBRD loans
  - EBRD, post-privatization financing, participation in transactions, SME support fund
  - JEXIM, FESAL co-financing
  - IMF, Consultation on formulation and monitoring of consolidated budget, TA for banking system
  - World Bank, TA services: ongoing consulting by IBRD to assist with BTC share sales; staff monitoring of isolation program and financial performance of large utilities; catalyzing foreign investment through IFC post-privatization investment finance; poverty assessment
  - World Bank, financing: IBRD investment loans and funding under TA loan to modernize and privatize BTC (communications); fast-disbursing IBRD loans to support financial and enterprise sector privatization and restructuring
- b) Financial Sector Reform
  - EU, technical assistance to upgrade banking supervision
  - Canada, financing for budgetary support
  - KfW, grant for coal sector restructuring
  - France, grant for BSES development
  - Britain, grant for advisory services for SSEC
  - EU/EBRD, grant for SME development
  - Netherlands, grant to foster SME development
  - World Bank, fast disbursing IBRD loans to support financial and enterprise sector privatization and restructuring; catalyzing foreign investment through IFC post-privatization investment finance; IFC support for establishment of a private bank; selected IFC investments in non-bank financial institutions; technical coordination and advisory work by IFC and vehicle for SME financing
- c) Agriculture and Rural Development
  - EU-Phare, Land restitution; market information; possibly agricultural research
  - Netherlands, Irrigation Project Support
  - Japan PHRD, grant to prepare IBRD financing
  - World Bank, technical and advisory services
  - World Bank, financing: IBRD loan to support land restitution; fast-disbursing loans conditioned on progress with elements of agricultural policy reform strategies; investment loans to facilitate development of warehouse receipts and external trade infrastructure; investment loan for irrigation system restructuring; investment loan for land cadastre; and, investments in vineyard development and/or grain storage facilities

## **GEORGIA**

### **1. Fiscal Policy and Public Sector Reform Revenue**

- a) Improve Tax Administration
  - IMF, World Bank
- b) Improve revenue raising capacity as well as the equity and buoyancy of the tax system
  - IMF and World Bank

- c) Improve Customs Administration
  - IMF, UNCTAD, World Bank

## **2. Expenditure and Budget Control**

- a) Improve Expenditure Control and Management
  - IMF and World Bank
- b) Re-orient public sector expenditure priorities
  - World Bank

## **3. Monetary Policy**

- a) Improve National Bank Operations
  - IMF and World Bank
- b) Improve Banking Environment
  - IMF and World Bank

## **4. Private Sector Development**

- a) Improve Legal Framework; Build the Institutions Necessary for an Efficient Development of the Private Sector
  - World Bank, IMF

## **5. Legal Framework and Judicial Reform**

- a) Review the Enforcement of Laws and Regulations
  - World Bank
- b) Increase Capacity to Plan, organize, administer, and Manage the Court System
  - World Bank

## **6. Trade and Exchange Regime**

- a) Liberalize Further the Exchange and Trade Systems
  - World Bank, IMF

## **7. External Debt**

- a) Normalize Relations with Creditors
  - IMF

## **8. Agriculture Sector**

- a) Develop Private Sector Agriculture
  - World Bank, EBRD, EU-TACIS

## **KYRGYZ REPUBLIC**

### **1. Consolidate Macroeconomic Stability and Creditworthiness Sustainability of Budgetary Outcomes and Policies**

- a) Revenues
  - IMF, ESAF, GTZ support to MoF
  - World Bank, lending: consolidation
  - World Bank, non-lending: policy framework paper, fiscal assessment, land tax study

- b) Expenditure Management Control
  - IMF, ESAF, EU/TACIS, UNDP
  - World Bank, Lending: public sector reform and management credit
  - World Bank, non-lending: country procurement assessment report and workshop (IDF), fiscal assessment
- c) External Financing of Deficit
  - IMF, ESAF
  - World Bank, non lending: external debt management, fiscal assessment, creditworthiness review

## **2. Sustained Growth Through Private Sector Development**

- a) Privatization and PSD – Enterprise and Governance
  - GTZ, ADB Corporate Governance Reform, Canada
  - World Bank, non-lending: state property fund (IDF grant), fiscal assessment
  - IFC, financing for post-privatization restructuring and PSD through investment funds and direct financing, SME development assistance
  - World Bank, non-lending: post privatization and PSD
  - IFC, training program on accounting
  - IFC, establishment of consulting firm
- b) Transparent Investment Climate
  - EBRD, IMF, ESAF
  - World Bank, lending: consolidation
  - World Bank, non-lending: State Property Fund
  - IFC/EDI, EDI seminar on FDI and free trade zone areas
  - IFC, research program for SME
- c) Financial Sector Deepening and Diversification – Banking Sector Reform, Non Bank financial institutions, Capital Markets, Labor Market Rigidities
  - GTZ, IMF, ESAF
  - World Bank, lending: consolidation, post-privatization
  - GTZ, support to insurance industry
  - World Bank, lending: FINSAC TA
  - World Bnk, non-lending: non-bank financial sector, post-privatization
  - IFC, housing finance fund, central depository
  - Swiss
  - World Bank, lending: social safety net
  - World Bank, non-lending: poverty update, poverty monitoring (IDF grant)
- d) Promoting Efficient and Profitable Agriculture – Land Privatization and Farm Restructuring; Marketing and Agricultural Support Services; Livestock Development; Irrigation and Rural Infrastructure; and, Rural Finance
  - IFAD, ADB, Swiss, SDC, FAO, UNDP, and NGOs
  - World Bank, lending: agricultural support services project; land registration project, sheep development project, rural infrastructure, livestock and pasture project, irrigation rehabilitation, on-farm irrigation, rural infrastructure
  - World Bank, non-lending: agricultural policy reviews, international agricultural conferences, land tax study, agricultural inputs marketing, livestock note
  - IFC, possible investments in agro-processing

## **LITHUANIA**

### **1. Maintaining Macro-Financial Stability**

- a) Reduced Economic Vulnerability/Strengthened Medium-term Fiscal Sustainability
  - IMF, regular consultations, possible programs
  - US Treasury, advice on tax and monetary policy, budget reform

- EU-Phare/Denmark, support for Treasury automation
  - World Bank, macro-financial vulnerability review, monitoring, public expenditure review, Y2K diagnosis
- b) Strengthened regulatory, supervisory framework for capital markets and non-bank institutions; restructuring banking and insurance sectors; Deepening financial markets, greater availability long-term credits and mortgages; Enhancing growth potential and competitiveness, EU accession
- EBRD, other investments in financial institutions
  - Denmark, TA for developing mortgage financing system
  - Canada, support for credit union strengthening
  - IMF, regular consultations, possible programs
  - World Bank, EFSAL supervision, TA on financial sector regulation framework, with focus on capital markets and non-banks, including pension funds, public support for development of mortgage banks
  - IFC, potential investment in financial sector, including banks, housing finance, venture capital fund, insurance and leasing
  - IFC, TA and analysis on legal/regulatory framework for leasing
  - World Bank, EU accession study
  - IMF, regular consultations, possible programs

## **2. Implementing the Policies and Programs Identified as Being Central for EU Accession**

- a) Enhancing competitiveness – private sector growth; legal and judicial system; strengthened financial discipline; tax/fiscal system promotion and efficiency; largely privatized housing sector, well-functioning real estate market
- EU-Phare, support for privatization of insurance sector, credits for SMEs
  - Nordic, financing feasibility studies, project preparation
  - IFC, active pipeline of loan/equity investment projects, both greenfield and for post-privatization, modernization of medium/large companies
  - IFC, support for SMEs through financial sector projects, SME study for Baltics and Poland
  - IFC, FIAS study on administrative barriers to foreign investment
  - IFC, possible MIGA investment guarantees
  - World Bank, TA on privatization of Lithuania Gas, country financial accountability assessment, TA for reform of legislative process and judicial reform, TA for regulation of infrastructure, possible support for housing and real estate policies
  - Denmark/Netherlands, TA training on energy efficiency and housing privatization
  - Norway, TA for privatization of housing maintenance
- b) Raising Rural Productivity – EU accession; productivity and quality improvements; alleviation rural unemployment
- EU-Phare, support for agricultural restructuring, veterinary and phytosanitary control, land reform, regional policy, use of EU structural funds
  - World Bank, Private agriculture development project supervision, TA on land reform, registering, titling, rural living standards survey, IDF on agricultural statistics, study of implications of EU accession for agriculture, possible rural development project

## **HUNGARY**

### **1. Strengthen the Market Economy through Strong Sustainable Growth**

- a) Increased agricultural competitiveness
- EU-Phare, TA for EU pre-accession support ongoing
  - EU, work with credit cooperatives
  - IFC, support for privatization of key agro-industrial conglomerates
  - IFC, support to agricultural leasing operations
- b) Reduce market imperfections that inhibit growth and contribute to regional disparities
- IFC, support private sector power generation and distribution
  - IFC support water and sewerage sectors

- IFC, support establishment of credit rating agency
  - IFC, private sector support to remaining state owned banks
  - Local Banks
- c) Develop a workforce capable of responding to demands of market economy
- IFC, possible SME equipment leasing operation
  - IFC, possible support to private education initiatives

## **2. Further Rationalize the Role of the Public Sector**

- a) Place social security of sustainable footing; Pension and Healthcare Reform
- British Know-How Fund, closely collaborating with PSAL
  - EU-Phare, collaboration expected
  - IFC, possible support to private pension funds
  - IFC, possible support to private investment in health care

### **ACRONYMS**

ADB:	Asian Development Bank
EBRD:	European Bank for Reconstruction and Development
EBRD HRAZDAN:	(Armenia power project)
EC:	European Community
EDI:	Economic Development Institute (World Bank Group)
EDP:	Export Development Project
EIB:	European Investment Bank
ESAF:	Enterprise and Financial Sector Adjustment Loan
EU:	European Union
EU Phare:	EU Technical Assistance for E. Europe
FDI:	Foreign Direct Investment
FESAL:	Financial and Enterprise Sector Adjustment Loan
FESAL:	IBRD Structural Adjustment Loans
FINSAC:	Financial Sector Adjustment Credit
FPD:	Finance and Private Sector Development Vice Presidency
GTZ:	Gesellschaft für Technische Zusammenarbeit (TA)
IDF:	International Development Fund
IFC:	International Finance Corporation
ILO:	International Labor Organization
IMF:	International Monetary Fund
IMF EFF:	International Monetary Fund Extended Fund Facility
Japan PHRD:	Population and Human Resources Development
JEXIM:	Japan Export/Import Bank
KfW:	Kredit Anstalt für Wiederaufbau (project finance)
MIGA:	Multilateral Investment Guarantee Agency
MoF:	Ministry of Finance
NGO:	Non Government Organization
OHR:	Office of the High Representative
SIDA:	Society for International Development Agencies
SSEC:	Securities and Stock Exchange Commission
TACIS:	Technical Assistance, CIS (EU aid)
TRACECA:	Unit of EU focusing on transportation infrastructure in Trans Caucasus and Central Asia
UNCTAD:	UN Conference on Trade and Development
UNDP:	United Nations Development Program
UST:	US Treasury

Note: Information provided by Academy for Educational Development (AED), Washington, D.C., 5/24/99 refers to recent and ongoing activities, based on AED's study of ENI country strategies. World Bank strategies do not include all their donors, and some ENI countries were not available.

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